Habitat Conservation Fund:

Some State Agencies Need To Do More To Ensure the Fund Is Used Appropriately

April 1997
95110

The first copy of each California State Auditor report is free.
Additional copies are $3 each. You can obtain reports by contacting
the Bureau of State Audits at the following address:

California State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, California 95814
(916) 445-0255 or TDD (916) 445-0255 x 248

OR

This report may also be available
on the worldwide web
http://www.bsa.ca.gov/bsa/

CALIFORNIA STATE AUDITOR

April 21, 1997 95110

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the Bureau of State Audits presents its audit report concerning the use of the Habitat Conservation Fund (fund) by the state agencies receiving appropriations from the fund.

This report concludes that the agencies generally complied with the act creating the fund; however, the Santa Monica Mountains Conservancy and the State Coastal Conservancy paid $4.2 million more than necessary to conserve land and did not always comply with state laws. We also conclude that the Wildlife Conservation Board was unable to fulfill the act's spending goals. Finally, the Department of General Services did not adequately protect the State's interest when it agreed to pay $1.8 million more than the seller paid for the same land and has not provided clear land acquisition guidance to state agencies that acquire conservation land.

Respectfully submitted,

KURT R. SJOBERG
State Auditor

Enclosure

BUREAU OF STATE AUDITS
555 Capitol Mall, Suite 300, Sacramento, California 95814 Telephone: (916) 445-0255 Fax: (916) 327-0019

Table of Contents

Summary	***S-1***
Introduction	***1***
Chapter 1	
Two State Agencies Spent More Habitat Conservation Funds Than Necessary To Conserve Lands	9
Recommendations	***19***
Chapter 2	
The Wildlife Conservation Board Could Not Comply With Spending Goals for the California Wildlife Protection Act of 1990	21
Recommendations	***25***
Chapter 3	
The Department of General Services Does Not Always Provide Appropriate or Sufficient Guidance in Purchasing Conservation Lands	27
Recommendations	***32***
Responses to the Audit	
Resources Agency	35
California State Auditor's Comments on the Response From the Resources Agency	***39***
Santa Monica Mountains Conservancy	41
California State Auditor's Comments on the Response From the Santa Monica Mountains Conservancy	***63***

State Coastal Conservancy 69

California State Auditor's Comments on the Response From the State Coastal Conservancy ***81***

State and Consumer Services Agency 83

Department of General Services 84

California State Auditor's Comments on the Response From the Department of General Services ***89***

Summary

Audit Highlights...

We reviewed five agencies' use of the Habitat Conservation Fund and found that:

- ☑ ***The five agencies generally complied with the act.***
- ☑ ***The Santa Monica Mountains Conservancy and the State Coastal Conservancy spent approximately $4.2 million more than necessary and failed to deposit approximately $9.7 million in the state treasury as required by law.***
- ☑ ***The Wildlife Board could not comply with the act's spending goals because of constraints in its budget.***
- ☑ ***The Department of General Services paid $1.8 million more for a property than a nonprofit organization paid.***
- ☑ ***There is no clear statewide guidance for land acquisition because the Department of General Services has not developed or disseminated written policies and procedures.***

Results in Brief

The California Wildlife Protection Act of 1990 (act) established the Habitat Conservation Fund (fund) for the purpose of acquiring, restoring, or enhancing certain types of wildlife habitat. The act specifies certain annual appropriations of the fund totaling approximately $30 million to five agencies: the Wildlife Conservation Board (Wildlife Board), the Santa Monica Mountains Conservancy (Santa Monica Conservancy), the Department of Parks and Recreation, the State Coastal Conservancy (Coastal Conservancy), and the California Tahoe Conservancy. Additionally, the act requires the state agencies to comply with the State's property acquisition law when using the fund moneys to acquire land. Thus, most state agencies are subject to the review and approval of the Department of General Services' Office of Real Estate and Design Services (Office of Real Estate).

Our review focused on whether the five agencies used the fund moneys for purposes consistent with the act. We found that the agencies generally complied with the act; however, two agencies, the Santa Monica Conservancy and the Coastal Conservancy, engaged in practices that resulted in the State paying more than necessary to acquire land or land rights. Specifically, for the transactions we reviewed, we noted the following concerns:

- The Santa Monica Conservancy granted moneys to a related entity, which used promissory notes to finance land acquisitions. Additionally, in one instance, when the related entity could not make note payments on a land parcel, the Santa Monica Conservancy had to use the fund moneys to purchase the land from the entity. As a result, the Santa Monica Conservancy paid approximately $2.2 million in interest costs and late payment fees that it could have used to acquire, restore, or enhance additional wildlife habitats had it purchased the land outright. Further, we question the entity's legal authority to use promissory notes because the Santa Monica Conservancy does not have the expressed legal authority to finance land acquisitions in this manner.

- The Santa Monica Conservancy also did not exercise adequate control over some of its other transactions with the related entity. In one case, contrary to the terms of the agreement, the Santa Monica Conservancy paid the related entity in advance for a land restoration grant and did not require it to sufficiently support actual costs of performing the work. In another case, the Santa Monica Conservancy sold a parcel of state land for $8 million and deposited the money directly into this entity's account without obtaining authorization from the Legislature. Further, it did not prepare a grant agreement documenting the terms and conditions under which the related entity could use the money, nor did it require the related entity to properly account for its expenditures. As a result, the Santa Monica Conservancy did not adequately safeguard state moneys and circumvented the State's budget and appropriation process.

- The Coastal Conservancy granted $2 million to a nonprofit organization to acquire an easement the Coastal Conservancy expected to receive from a second nonprofit organization (seller) at no cost. In addition, it allowed the seller to use $300,000 of the proceeds to pay land management and other costs inconsistent with the purpose of the fund. Further, it required the seller to deposit the remaining $1.7 million into a private account until such time as the Coastal Conservancy requests disbursement of the money for deposit in the State Coastal Conservancy Fund. As a result, $2 million of the fund is no longer available to acquire, restore, or enhance additional wildlife habitats and at least $1.7 million of state money is not adequately safeguarded, as state law requires.

Further, we determined whether the fund was spent in the proportions the act specifies. We found that the State Resources Agency assigned the Wildlife Board's appropriation to specific programs but did not ensure compliance with the act's spending goals. As a result, the Wildlife Board could not spend its appropriation in compliance with the act.

Finally, our review of state land acquisitions found that the Office of Real Estate does not always provide sufficient guidance in purchasing conservation lands. We noted the following:

- For 1 of the 13 state land acquisitions we reviewed, the Office of Real Estate agreed to pay a nonprofit organization $1.8 million more than the nonprofit ultimately paid for the land. This occurred for two reasons: first, the Office of Real Estate based its purchase price on the original owner's

valuation, rather than obtain its own appraisal; second, the Office of Real Estate agreed to the purchase price before the nonprofit obtained ownership of the land. As a result, the State lost the use of at least $1.8 million from the fund that it could have applied toward acquiring, restoring, or enhancing additional wildlife habitats.

- The Office of Real Estate does not provide state agencies adequate written policies and procedures for property acquisitions, does not effectively communicate changes in its policies and procedures, and does not take the lead in addressing policy changes. As a result, there is no clear statewide policy for real property acquisitions, and agencies are sometimes using outdated information.

Recommendations

The Santa Monica Conservancy should:

- Improve its grant administration practices by requiring grantees to demonstrate the financial ability to complete a project before granting state funds; executing grant agreements that document the terms and conditions of the grant; ensuring grantees meet the terms and conditions before approving payment; requiring grantees to maintain records supporting costs of the work performed; and requiring grantees to separately account for the expenditures related to each grant.

- Deposit state moneys from the sale of state land into the state treasury and the fund established to receive the proceeds.

The Coastal Conservancy should deposit into the state treasury, and credit to the Habitat Conservation Fund, the moneys held by a nonprofit organization on its behalf. In addition, it should neither directly nor indirectly use the fund for purposes inconsistent with the act.

The State Resources Agency and the Wildlife Board should develop a system to ensure that the Wildlife Board's appropriation from the fund is allocated in the proportions necessary to fulfill the act's spending goals.

The Department of General Services should:

- Prohibit the execution of purchase agreements with individuals or organizations that do not own the land being acquired.

- Require individuals or organizations that facilitate the State's acquisition of land to disclose their financial arrangements with prior landowners before it agrees to a specific purchase price.

- Develop and distribute written policies and procedures for other state agencies that acquire real property to ensure consistency in state land acquisitions. If the department does not pursue its role as a statewide policysetter, the Legislature should direct the Department of General Services to set these policies.

In addition, the Legislature should:

- Amend the provisions of the Santa Monica Mountains Conservancy Act to clarify the legal authority of the Santa Monica Conservancy, and thus the legal authority of the related entity, to use promissory notes to finance land acquisitions.

- Consider adding a provision to the act that requires state agencies to deposit into the fund the proceeds from the sale of land originally purchased with the fund.

Agency Comments

In its response, the Resources Agency is pleased that we found that agencies generally complied with the act. However, it disagrees with our conclusion that the Wildlife Board could not comply with the spending goals for the act and contends that the Wildlife Board complied with the spending goals to the extent practicable.

The Santa Monica Conservancy strongly disagrees with our conclusion that it spent more than necessary to acquire land and restates its position that it has the legal authority to issue promissory notes. It also strongly disagrees with our conclusion that it should have deposited proceeds from the sale of state land into the state treasury and believes that its actions were consistent with the act. Finally, although it questions the need

for improved documentation and record keeping, it has agreed to implement some of these recommendations.

The Coastal Conservancy strongly disagrees with our conclusion that it paid for an easement it expected to receive at no cost and that it is improperly holding state funds outside the state treasury or that it used fund moneys to pay disallowed costs.

The Department of General Services does not believe that the State paid too much to acquire a parcel of land because the purchase price was based on a properly approved appraisal. Additionally, although it contends it provides adequate guidance, it will take action to develop and distribute guidelines to assist other state agencies that acquire real property.

Our rebuttals to each of the entity's assertions follow their respective responses.

Introduction

Background

The California Wildlife Protection Act of 1990 (act), added to California law as Chapter 9 of the Fish and Game Code, originated with the passage of Proposition 117 in June 1990. The Fish and Game Code, Section 2786, established the Habitat Conservation Fund (fund) and specifies that the fund be used for the following purposes:

- The acquisition of habitat, including native oak woodlands, necessary to protect deer and mountain lions.

- The acquisition of habitat to protect rare, endangered, threatened, or fully protected species.

- The acquisition of habitat to further the Habitat Conservation Program, such as habitat for unique species or natural communities that are found only at a single location in California; habitat for species that occur in 20 or fewer locations in the world; a natural community habitat that occurs in only 50 or fewer locations in the world; or a combination of three or more rare species or natural communities habitat, of which at least one is found in only 20 or fewer locations in the world.

- The acquisition, restoration, or enhancement of wetlands. Wetlands may be covered periodically or permanently with shallow water (e.g., saltwater marshes, freshwater marshes, and swamps).

- The acquisition, restoration, or enhancement of aquatic habitat for the spawning and rearing of migrating salmon and trout.

- The acquisition, restoration, or enhancement of riparian habitat. Riparian habitat borders a freshwater source and depends on its moisture.

The act also requires state agencies to comply with the State's property acquisition law when using the fund to acquire properties. This law authorizes the State Public Works Board

(Public Works Board) to acquire real property for any state purpose or function and exempts the Wildlife Conservation Board, among other agencies, from its provisions. The Department of General Services' Office of Real Estate and Design Services (Office of Real Estate) provides services for the Public Works Board, including appraisal, appraisal review, and land acquisition.

Additionally, the act apportions the fund to five state agencies organized within the State Resources Agency. These five state agencies are described below:

- Wildlife Conservation Board (Wildlife Board)—acquires, preserves, protects, and restores wetlands, riparian habitat, and wildlife habitat and provides public access to fish and wildlife resources.

- Santa Monica Mountains Conservancy (Santa Monica Conservancy)—acquires and restores lands for parks, recreation, or conservation in the Santa Monica Mountains Zone, the Rim of the Valley Corridor, and the Santa Clarita Woodlands areas.

- Department of Parks and Recreation (Parks and Recreation)—acquires, develops, or preserves the natural, cultural, and recreational resources in the state park system.

- State Coastal Conservancy (Coastal Conservancy)—acquires, restores, enhances, and preserves lands in the coastal zone and provides public access to these areas.

- California Tahoe Conservancy (Tahoe Conservancy)—acquires and manages land in the Lake Tahoe region to protect and preserve wildlife habitat and the natural environment and provides public access and recreational facilities.

Finally, the act provides for the transfer of $30 million annually until 2020 to the fund from the State's General Fund or from various environmental and conservation funds. For fiscal years 1992-93 through 1994-95, no General Fund moneys were transferred to the fund. The act specifies the annual appropriations each agency receives. Table 1 shows the appropriations for fiscal years 1990-91 through 2019-20.

Table 1

Annual Agency Appropriations (Amounts in Millions)

Agency	Annual Appropriations Fiscal Years 1990-91 to 1994-95	Annual Appropriations Fiscal Years 1995-96 to 2019-20	Total Appropriations Over 30 Years
Wildlife Board	$11.0	$21.0	$580.0
Santa Monica Conservancy	10.0	*	50.0
Parks and Recreation	4.5	4.5	135.0
Coastal Conservancy	4.0	4.0	120.0
Tahoe Conservancy	0.5	0.5	15.0
Total	**$30.0**	**$30.0**	**$900.0**

*In accordance with the act, the Santa Monica Conservancy was appropriated $10 million yearly for fiscal years 1990-91 through 1994-95 only. Beginning in fiscal year 1995-96, this $10 million was appropriated to the Wildlife Board, raising its annual appropriation from $11 million to $21 million for the next 25 years.

For fiscal years 1992-93 through 1994-95, the five state agencies reported spending approximately $96.2 million of the fund on 199 projects. We grouped these projects into the following three categories:

- State Land Acquisition Projects—acquisitions in which the state agencies acquire and own the land.
- Land Acquisition Grant Projects—grant agreements in which the state agencies provide funds to other entities, such as local agencies or nonprofit organizations, to acquire and own the land.
- Land Restoration or Enhancement Projects—contracts or grant agreements in which the state agencies arrange for other entities to restore or enhance lands owned by the state or by other public and private parties.

Figure 1 provides a breakdown of the five agencies' reported expenditures of the fund in fiscal years 1992-93 through 1994-95:

Figure 1

Fund Expenditures by Project Type
Fiscal Years 1992-93 Through 1994-95
(Amounts in Millions)

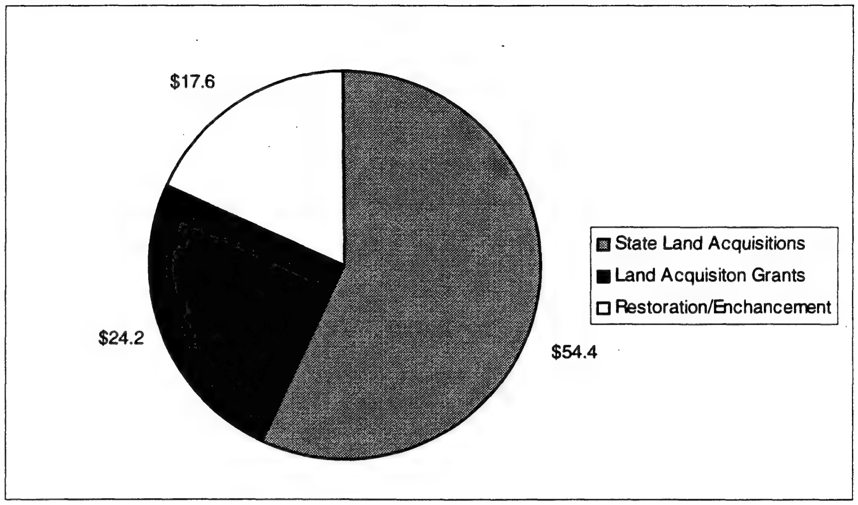
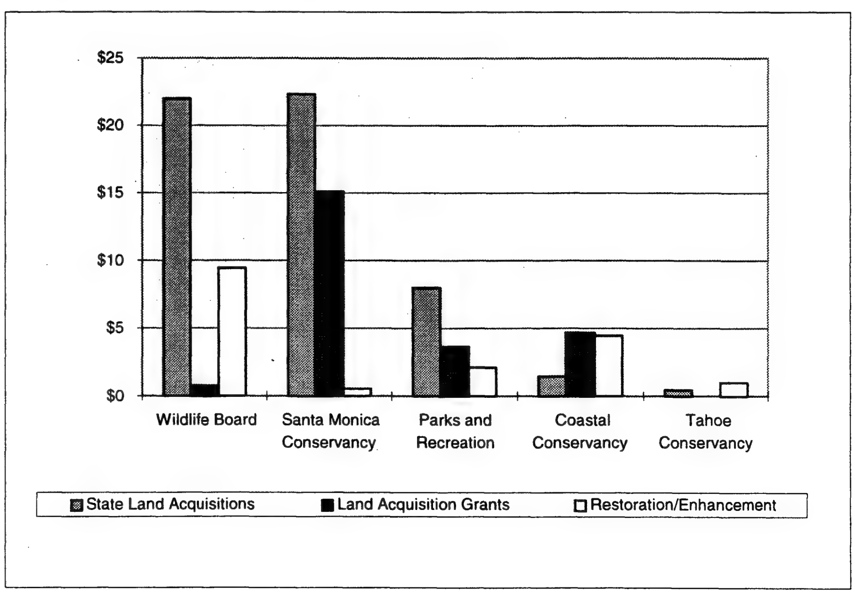


Figure 2 presents a breakdown of the fund expenditures reported by each agency for fiscal years 1992-93 through 1994-95.

Figure 2

Fund Expenditures by Agency and Project Type
Fiscal Years 1992-93 Through 1994-95
(Amounts in Millions)



As shown in Figure 2, the Wildlife Board and the Santa Monica Conservancy had the highest expenditures, which is consistent with the amount of the fund appropriated to each.

Scope and Methodology

At the request of the Joint Legislative Audit Committee, we conducted an audit of the use of the Habitat Conservation Fund by the five agencies receiving appropriations. To perform our audit, we reviewed pertinent state laws and regulations. We determined whether the fund was appropriated as required and spent as intended by the act. In addition, we determined whether the agencies complied with the State's property acquisition law and with other laws applicable to the disposition or transfer of property. Further, we determined whether the agencies managed the properties acquired with the fund in compliance with applicable laws. Finally, we determined whether the agencies had adequate conflict-of-interest policies and procedures.

To determine whether the fund was appropriated as required by the act, we reviewed the amounts appropriated from the fund to each state agency for fiscal years 1992-93 through 1994-95 and compared the amounts to the annual appropriations specified in the act. We found that the agencies received the annual appropriations specified in the act.

Next, we reviewed and evaluated the appropriateness of transfers to the Habitat Conservation Fund from other funds for these same fiscal years. Although not in the period of our review, it came to our attention that in fiscal years 1995-96 and 1996-97, a total of $400,000 was transferred from the California Waterfowl Habitat Preservation Account in the Fish and Game Preservation Fund to the Habitat Conservation Fund, which the act specifically prohibits. We addressed this issue in a separate management letter to the Department of Finance.

To determine whether the agencies spent the fund moneys as intended by the act, we analyzed the agencies' project expenditure information for fiscal years 1992-93 through 1994-95 and evaluated whether the Wildlife Board complied with the spending goals the act imposed.

We then reviewed a sample of projects from each agency to evaluate whether they used the fund as stipulated by the act. We selected projects with large dollar per acre amounts, frequent payments to the same entities or individuals, and from each of the three project categories. For those selected, we reviewed agency documents, such as board minutes, purchase

agreements, and grant agreements, which describe how the projects met the purpose of the fund. Finally, we spoke with agency staff responsible for administering the projects to obtain an understanding of the purpose of each project.

We examined the reviews and approvals made by the Office of Real Estate on behalf of the Public Works Board or the Wildlife Board for the projects we selected to determine whether the agencies acquired land in accordance with the State's property acquisition law. Further, we reviewed the Office of Real Estate's approval of property appraisal reports used to support the amounts paid for the acquired properties. Additionally, we retained a consultant to assist us in examining certain appraisals.

To determine whether the agencies complied with laws related to the disposition or transfer of properties, we reviewed sales or transfers of property acquired with the fund. We evaluated whether the property sale or transfer was authorized by law and approved by the Public Works Board. Further, we verified that the agencies deposited the sales proceeds in the appropriate fund.

To discover whether the state agencies managed lands acquired with the fund in compliance with the act, we obtained the land management plans for the relevant properties in our sample. We reviewed the plans to evaluate whether they addressed the California Environmental Quality Act requirements and ensured reasonable public access to the land. Further, we reviewed land management field inspection reports or similar documents to determine whether the agencies managed the properties in accordance with the act.

Finally, we determined if state agencies had adequate conflict-of-interest policies and procedures, by comparing conflict-of-interest codes and incompatible activities policies for each agency and the Department of General Services with the requirements in Government Code, Sections 87300 and 19990. Further, we identified individuals involved with decisions related to acquisitions, grants, or contracts, reviewed their annual Statements of Economic Interest, and examined reports of potential conflicts of interest.

We did not identify conflicts of interest; however, we found that the Department of Parks and Recreation, the Department of General Services and the Department of Fish and Game, which includes the Wildlife Board, did not maintain current conflict of interest codes.

Therefore, these agencies did not properly identify employees who were required to file an annual Statement of Economic Interest. We addressed this finding in a separate management letter to each agency.

Chapter 1

Two State Agencies Spent More Habitat Conservation Funds Than Necessary To Conserve Lands

Chapter Summary

Our review of the five agencies that receive Habitat Conservation Fund (fund) moneys revealed that the agencies used the moneys to acquire, restore, or enhance the types of land specified in the Wildlife Protection Act of 1990 (act). However, two agencies, the Santa Monica Mountains Conservancy (Santa Monica Conservancy) and the State Coastal Conservancy (Coastal Conservancy), engaged in one or more transactions that resulted in the State paying more than necessary to acquire land or property rights. Furthermore, both of these agencies did not always deposit funds into the state treasury, as the law requires.

Specifically, the Santa Monica Conservancy granted fund moneys to a related entity, the Mountains Recreation and Conservation Authority (Mountains Authority), which used promissory notes to finance land acquisitions. A promissory note is a promise to pay a specified amount of money at a stated time and rate of interest. As a result, for land acquisitions we reviewed totaling $25.3 million, the Santa Monica Conservancy paid at least $2.2 million in interest and late payment fees.

Furthermore, because the Santa Monica Conservancy did not require the Mountains Authority to demonstrate an ability to make future payments on the notes, the Mountains Authority risks losing the land if it is unable to meet the terms of the promissory notes. For one land acquisition we reviewed, the Santa Monica Conservancy eventually purchased the land from the Mountains Authority because the Mountains Authority did not have the money to pay the note when it became due. Moreover, we question the Mountains Authority's legal authority to use promissory notes to finance the acquisition of land.

We also found that the Santa Monica Conservancy did not exercise adequate control over some of its transactions with the Mountains Authority. In one case, contrary to the terms of the grant agreement, the Santa Monica Conservancy paid

$166,000 to the Mountains Authority for land restoration work before the work was completed. In another case, the Santa Monica Conservancy did not deposit the proceeds from the sale of state lands into the Santa Monica Mountains Conservancy Fund, as required by state law. Instead, it deposited the state moneys directly into an account of the Mountains Authority without obtaining legislative authority to use the moneys and without preparing an agreement documenting the terms and conditions of the grant.

Another agency, the Coastal Conservancy granted $2 million of the Habitat Conservation Fund to purchase a conservation easement, which restricts the use of land to preserve its natural resources; however, it expected to receive the easement at no cost. In this transaction, the Coastal Conservancy also allowed a nonprofit organization to use $300,000 of the $2 million to pay for land management fees and other costs inconsistent with the purpose of the Habitat Conservation Fund. Further, the Coastal Conservancy required the nonprofit organization to deposit the remaining $1.7 million into an interest-bearing account for disbursement to the Coastal Conservancy. This transaction occurred in June 1996; as of January 1997, the Coastal Conservancy had not collected and deposited the remaining $1.7 million of these state moneys into the treasury, as the law requires.

The Santa Monica Conservancy Used a Related Entity To Purchase Land

The Santa Monica Conservancy and two local park and recreation districts created the Mountains Authority.

The Santa Monica Conservancy acquired land directly from or through a related entity known as the Mountains Authority. The Mountains Authority was created by an agreement between the Santa Monica Conservancy and two local park and recreation districts. According to the agreement, the Mountains Authority was established to coordinate the powers, authority, and expertise of the Santa Monica Conservancy and the two local park and recreation districts in the acquisition, development, and conservation of certain lands. This agreement provides the Mountains Authority with all the powers common to the parties to the agreement and such other powers as may be applicable to local park agencies. Further, the agreement provides that the executive director of the Santa Monica Conservancy serve as the executive officer of the Mountains Authority. The Mountains Authority receives its revenues primarily through grants.

The Santa Monica Conservancy Paid Significant Interest Costs

Of the $50 million it received from the fund, the Santa Monica Conservancy provided approximately $46.7 million (94 percent) to the Mountains Authority, so for our review of the Santa Monica Conservancy, we selected transactions involving the Mountains Authority. Specifically, we reviewed five land acquisition grants totaling approximately $8.5 million, two purchases of land totaling approximately $16.8 million, and one restoration grant for $450,000.

The Mountains Authority's use of promissory notes to purchase land is costly and risky.

With the approval of its board, the Santa Monica Conservancy granted fund moneys to the Mountains Authority to acquire land through the use of promissory notes which resulted in the Santa Monica Conservancy paying at least $2.2 million in interest costs and late payment fees. Considering the high interest costs and potential risk of loss when using promissory notes, we question whether the Santa Monica Conservancy's practice of granting funds for principal and interest payments on promissory notes serves the best interests of the State.

The Mountains Authority Uses Promissory Notes and Incurs Interest Charges

Using promissory notes allows the Mountains Authority to secure property with a minimum down payment. Four of the five land acquisition grants we reviewed involved purchases using promissory notes. Generally, the Mountains Authority uses the grants to make a down payment and pay the principal and interest on the note until other funds become available to pay off the note.

Although we recognize the Santa Monica Conservancy's desire to secure several properties with limited funds, we question the prudence of using state funds to acquire lands through the use of promissory notes. First, the State Public Works Board, the entity responsible for acquiring lands for the State, typically purchases land outright or acquires it through condemnation. It does not use notes to finance land acquisitions. We believe that state agencies that do not have the funds to purchase lands outright should take more prudent action, such as requesting and obtaining additional funding from the Legislature or seeking other sources to buy the desired land. Second, if additional funding does not materialize and the notes cannot be paid, the State risks losing rights to the lands and the moneys already invested. Third, we question the prudence of state agencies using limited public resources to pay interest charges on

promissory notes. These moneys could be better used to acquire additional land. Finally, we believe state agencies should require other public or private agencies to show the financial ability to make future payments before providing them with state funds to acquire lands.

The Santa Monica Conservancy's purchase of Paramount Ranch illustrates the risks and interest costs associated with the use of promissory notes. In April 1991, the Santa Monica Conservancy authorized the Mountains Authority to purchase a delinquent note and then foreclose on the note to acquire the property known as Paramount Ranch. In July 1991, it granted $512,000 from the fund for the down payment and closing costs. Once it acquired the land, the Mountains Authority planned to sell it to the United States National Parks Service (National Parks Service) and use the sale proceeds to pay off the note and related costs.

The Santa Monica Conservancy paid $3 million more for the Paramount Ranch than if it had purchased the ranch outright.

The Mountains Authority purchased the delinquent note from a bank for $15.5 million by making an initial payment of $500,000 and issuing a $15 million promissory note to the bank. It successfully foreclosed on the delinquent note and obtained ownership of the land. However, because it was unable to sell the ranch to the National Parks Service as planned, the Mountains Authority had to restructure the promissory note. Consequently, the Santa Monica Conservancy granted the Mountains Authority the additional $5 million it needed to renegotiate the note and extend its due date to June 1993.

Nevertheless, the Mountains Authority was still unable to meet the terms of the amended note and once again found it necessary to modify the note, making a $1 million principal payment from its own funds and further extending the due date to September 1993. As of September 1993, the Mountains Authority needed $9 million to pay off the note and approximately $2.1 million to pay the interest. Instead of giving the Mountains Authority a grant to pay off the note and interest, in September 1993, the Santa Monica Conservancy purchased the property from the Mountains Authority for its then-current appraised value of approximately $13 million. Approximately $7 million of this amount came from the fund.

According to the executive director, the Santa Monica Conservancy paid the full appraised value so that the Mountains Authority would receive enough proceeds from the sale to pay off the note plus interest and recover its payments for past interest and other costs. As a result, the Santa Monica Conservancy paid the Mountains Authority more than $18.5 million for land it could have purchased outright for

$15.5 million. Approximately $3 million of the Santa Monica Conservancy payment represents interest costs. We calculated the fund's pro rata share of these interest costs to be approximately $1.6 million.

In another instance, the Santa Monica Conservancy gave the Mountains Authority two grants, one in July 1991 and another in October 1992, totaling $1.3 million so the Mountains Authority could make principal and interest payments on promissory notes used to finance the purchase of lands in Towsley Canyon. Our review found that the Mountains Authority used approximately $607,000 of the grant funds to pay interest charges and approximately $7,000 to pay late payment penalties.

The Legality of the Mountains Authority's Use of Promissory Notes Is Questionable

In addition to questioning the prudence of financing land purchases by using promissory notes, we question the Mountains Authority's legal authority to use them. The Mountains Authority was created under Government Code, Section 6502, which provides this agency only with the powers that are common to the parties of the agreement. Although the two park districts have the expressed legal authority to use promissory notes to finance land purchases, the Santa Monica Conservancy does not. Therefore, even though the agreement specifies that the Mountains Authority's powers are equal to those of the local park districts, it cannot expand the powers of the Mountains Authority beyond the powers shared by all of the parties. If the right to use promissory notes to finance land purchases is not common to all the parties of the agreement, the Mountains Authority cannot legally use promissory notes to finance land purchases.

Because the Santa Monica Conservancy does not have the expressed legal authority to use promissory notes, we question the Mountains Authority's legal power to use this method for land acquisition.

Although the use of promissory notes to finance the acquisition of land is not expressly conferred by law to the Santa Monica Conservancy, the Santa Monica Conservancy believes that such actions are allowed under the general provisions of its statute. The Santa Monica Conservancy relied on the advice of its staff counsel and more recently on an advice letter from the Office of the Attorney General (attorney general) regarding the legality of its use of promissory notes to purchase land.

Specifically, the attorney general broadly interprets the Public Resources Code, Section 33207.5(e), which authorizes the sale of specific land from a school district to the Santa Monica Conservancy. A part of subsection (e) also permits the Santa Monica Conservancy's executive director to take such actions

necessary to carry out the provisions of the Santa Monica Mountains Conservancy Act, notwithstanding the provisions of the State's property acquisition law.

The attorney general argues that the authority provided by the subsection is not limited to the acquisitions of the specific school district lands discussed in the section but empowers the Santa Monica Conservancy's executive director to take such action as necessary to carry out the general provisions creating the Santa Monica Conservancy. The broad interpretation of this subsection, in effect, grants the Santa Monica Conservancy's executive director all the power necessary to obtain land, including the use of promissory notes to finance the acquisition of lands.

Our legal counsel does not agree with the attorney general's broad interpretation of the law, however. According to our legal counsel, the Santa Monica Conservancy's authority should be interpreted narrowly according to the complete language of subsection (e) and the other sections of the provisions creating the Santa Monica Conservancy and the State's property acquisition law. Consequently, the Mountains Authority would not have the power to execute promissory notes.

We believe that the attorney general's broad interpretation of a clause within a section dealing with a specific land acquisition does not provide reasonable support for his conclusion; therefore, we question the Mountains Authority's legal power to use promissory notes to finance land purchases.

The Santa Monica Conservancy Did Not Exercise Adequate Control Over Some of Its Other Transactions With the Mountains Authority

Contrary to the terms of the grant, the Mountains Authority received $166,000 in payment for land restoration work prior to completion.

We found that the Santa Monica Conservancy did not exercise adequate control over some of its transactions with the Mountains Authority. In one case, contrary to the terms of the grant agreement, the Santa Monica Conservancy paid $166,000 to the Mountains Authority for land restoration work before the work was completed. In another case, the Santa Monica Conservancy did not deposit the proceeds from the sale of state lands into the Santa Monica Mountains Conservancy Fund, as required by state law. Instead, it granted and deposited the state moneys directly into an account of the Mountains Authority without obtaining legislative approval to use the moneys and without preparing an agreement documenting the terms and conditions of the grant.

To protect state funds, agencies need to practice effective grant management, including preparing written agreements that document the terms and conditions the grantee must meet to receive the funds. Additionally, grant managers should review requests for payment to ensure they are consistent with the prescribed terms and conditions. Further, they should monitor the work performed to ensure that the grantee provides the required deliverables before receiving payment. Finally, grant managers should monitor the grantee's expenditures to ensure it adequately accounts for use of grant moneys and maintains sufficient supporting documentation.

For the one restoration grant we reviewed, some of these requirements were not met. In September 1992, the Santa Monica Conservancy granted $450,000 from the fund to complete restoration work on lands managed by the Mountains Authority. The terms of the grant agreement extended through June 30, 1993, and provided that compensation be paid upon the Mountains Authority's submission of an invoice for the work completed. In August 1993, the Mountains Authority submitted an invoice for $450,000 stating that it had completed all terms and conditions of the agreement, and the Santa Monica Conservancy approved payment.

Furthermore, grant payments totaling $281,000 were not adequately supported.

However, our review of the Mountains Authority's accounting records found that, as of June 30, 1993, this agency charged approximately $284,000 to the restoration grant. It incurred the remaining $166,000 of expenditures during the following fiscal year ending June 30, 1994.

According to the executive director, the Santa Monica Conservancy paid the Mountains Authority the full amount of the grant to improve the Mountains Authority's cash flow. Although advance payments may be appropriate when the grantee incurs start-up costs or requires reasonable working capital to perform services requested by the State, we question the appropriateness of this advance to the Mountains Authority. The Mountains Authority spent the $166,000 advance over the following fiscal year primarily for routine payroll expenses; therefore, it did not have an immediate need for the entire advance.

Furthermore, we found that the Mountains Authority could not adequately support approximately $281,000 (63 percent) of the expenditures it charged to this grant. Specifically, the Mountains Authority charged payroll costs totaling approximately $247,000 to the restoration grant using predetermined percentages approved by the Santa Monica Conservancy, rather than the actual hours worked by its employees, and did not have documentation supporting the

basis for these percentages. Additionally, the Mountains Authority awarded a subgrant to a nonprofit organization for general land management, federal emergency, and habitat restoration work and charged approximately $34,000 of the subgrant costs to the restoration grant, even though the nonprofit organization's invoices do not include charges to the habitat restoration work category. As a result, we were unable to determine if the payroll and subgrantee expenditures were properly charged to the grant.

The Santa Monica Conservancy Did Not Deposit Fund Moneys in Accordance With State Law or Account for Their Disposition

The Santa Monica Conservancy circumvented the State's processes by depositing $8 million from the sale of state land directly into the Mountains Authority account.

The Santa Monica Conservancy did not deposit state moneys from the sale of land into the Santa Monica Mountains Conservancy Fund in accordance with state law; instead, it deposited the moneys directly into an account of the Mountains Authority. As a result, the Santa Monica Conservancy circumvented the State's budget and appropriation process. Furthermore, neither adequately accounted for its use of these moneys.

In one instance, contrary to various provisions of law, the Santa Monica Conservancy did not properly deposit the proceeds from the sale of a parcel into a state account. In May 1995, the Santa Monica Conservancy sold a parcel to the National Parks Service for $8 million, of which the fund's share was approximately $4.3 million. Public Resources Code, Section 33205, requires the Santa Monica Conservancy to deposit moneys received from the sale of land into the Santa Monica Mountains Conservancy Fund, which is subject to appropriation by the Legislature. Also, Government Code, Sections 16305.2 and 16305.3, requires state agencies to deposit state moneys into the state treasury system.

However, we found that the Santa Monica Conservancy did not deposit the state moneys as required. Instead, the Santa Monica Conservancy deposited the state moneys directly into an account of the Mountains Authority. According to the executive director, the Santa Monica Conservancy did this because the California Wildlife Protection Act of 1990 is silent regarding the disposition of proceeds from the sale of lands purchased through the use of the Habitat Conservation Fund. Additionally, he stated that the moneys deposited in the Santa Monica Mountains Conservancy Fund would be subject to possible appropriation by the Legislature for other purposes. Therefore, the Santa Monica Conservancy found it appropriate not to deposit the proceeds in the Santa Monica Conservancy

Fund. Instead, it granted the proceeds directly to the Mountains Authority for use on projects that are consistent with the purpose of the Habitat Conservation Fund. Nonetheless, the Santa Monica Conservancy should have deposited the proceeds in accordance with state laws. Granting the proceeds without legislative authorization circumvented the State's budget and appropriation process.

Furthermore, the Santa Monica Conservancy board approved resolutions granting the sale proceeds to the Mountains Authority for two land acquisition projects; however, the Santa Monica Conservancy did not prepare an agreement documenting the terms and conditions of this grant. According to the Santa Monica Conservancy, the Mountains Authority used the proceeds for three projects. However, our review of the Mountains Authority's accounting records found that it did not separately account for the expenditures related to this grant. This lack of documentation on the part of both agencies prevented us from linking the proceeds and the related expenditures. Thus, we could not determine the disposition of the sale proceeds.

The Coastal Conservancy Granted $2 Million for a Conservation Easement It Expected To Receive at No Cost

The Coastal Conservancy arranged the transfer of $1.7 million of fund moneys to another fund and paid $300,000 in disallowed costs.

We reviewed six Coastal Conservancy projects totaling $4.8 million: three acquisition grants, one state land acquisition, and two restoration or enhancement projects. For one acquisition grant, with the approval of its board, the Coastal Conservancy granted $2 million from the fund to one nonprofit organization (nonprofit A) to acquire a conservation easement the Coastal Conservancy expected to receive from another nonprofit organization (nonprofit B) at no cost. In addition, it allowed nonprofit B to use $300,000 of the $2 million sale proceeds to pay land management and other costs that the act disallows. Finally, contrary to state law, the Coastal Conservancy authorized nonprofit B to deposit the remaining $1.7 million in an account outside the state treasury system for disbursement to the Coastal Conservancy at a later date.

Specifically, in March 1987, the Coastal Conservancy loaned nonprofit B $1.1 million to purchase land in Mendocino County's Sinkyone Wilderness (Sinkyone). According to a March 1995 report on the disposition of the Sinkyone property, the Coastal Conservancy expected that upon the sale of the property a conservation easement would be transferred at no cost to the Coastal Conservancy or another designated party.

Nonetheless, in June 1996, the Coastal Conservancy granted nonprofit A $2 million from the fund to purchase the conservation easement on the Sinkyone land. The Coastal Conservancy also modified its loan agreement with nonprofit B authorizing it to sell the conservation easement to nonprofit A for $2 million. The modified agreement stipulated that nonprofit B use $250,000 of the sale proceeds to pay land and easement management costs; compensate Mendocino County $50,000 for lost tax revenues; and deposit the remaining $1.7 million in an interest-bearing account for disbursement to the Coastal Conservancy, upon its request, within two years. According to the March 1995 report, the Coastal Conservancy chose to have the Habitat Conservation Fund pay for the easement so that the additional revenues could be deposited in its Coastal Conservancy Fund, which the staff describe as its "most flexible" funding source. However, as of January 1997, these moneys were still on deposit in the nonprofit's name.

Although the Coastal Conservancy can use the fund to purchase easements, we believe the above transaction disregarded the intent of the act. Specifically, since the Coastal Conservancy already expected to receive the easement at no cost, there was no need to grant $2 million from the fund to acquire this easement. Also, because the act does not allow the fund to be used for land management and other costs, the Coastal Conservancy circumvented these restrictions by directing nonprofit B to use the sale proceeds to pay for these costs. Additionally, because the Coastal Conservancy plans to deposit the remaining $1.7 million plus interest in its Coastal Conservancy Fund, the spending restrictions imposed by the act will no longer apply. As a result, $2 million from the fund is no longer available to acquire, restore, or enhance wildlife habitats as the act intends.

Also, in violation of state law, the Coastal Conservancy directed the deposit of $1.7 million in sale proceeds outside of the state treasury system.

Furthermore, directing nonprofit B to deposit the $1.7 million in an interest-bearing account violated Government Code, Sections 16305.2 and 16305.3, requiring agencies to deposit state moneys in the state treasury system. As a result, $1.7 million of state money was also not adequately safeguarded as required by law.

Conclusion

The Santa Monica Conservancy and the Coastal Conservancy paid more than necessary to acquire and protect conservation lands. As a result, the fund lost the use of approximately $4.2 million the State could have used to acquire, restore, or enhance additional wildlife habitats and important natural areas. Additionally, the Santa Monica Conservancy did not

areas. Additionally, the Santa Monica Conservancy did not exercise adequate control over some of its transactions with the Mountains Authority. Finally, both conservancies failed to deposit moneys in the state treasury as the law requires. As a result, the Santa Monica Conservancy bypassed the State's budget and appropriation process when it deposited $8 million from the sale of state land directly into the account of the Mountains Authority. Further, $1.7 million of the Coastal Conservancy's money remains on deposit outside the state treasury.

Recommendations

To improve its grant administration, the Santa Monica Conservancy should:

- Require grantees to demonstrate the financial ability to complete a project before granting state funds.

- Prepare and execute formal agreements that document the terms and conditions grantees must meet to receive payments.

- Require grantees to maintain documentation that adequately supports the actual costs of the work performed.

- Ensure the grantee has met the terms and conditions of the grant before approving payment.

- Require grantees to separately account for each grant and its related expenditures.

- Deposit proceeds from the sale of state lands into the state treasury and the fund established to receive such proceeds.

The Coastal Conservancy should:

- Promptly collect and deposit into the state treasury, and the fund, the state moneys that the nonprofit is holding on its behalf.

- Neither directly nor indirectly use the fund for purposes inconsistent with the Wildlife Protection Act of 1990.

To clarify the legality of Santa Monica Conservancy's use, and thus the Mountains Authority's use, of promissory notes to finance the purchase of land, the Legislature should modify the provisions of the Santa Monica Mountains Conservancy Act.

Finally, to ensure that proceeds from the sale of land or property rights purchased with the fund are used to further the intent of the act, the Legislature should consider an amendment to the act requiring state agencies to redeposit these moneys into the fund.

Chapter 2

The Wildlife Conservation Board Could Not Comply With Spending Goals for the California Wildlife Protection Act of 1990

Chapter Summary

During the State's budget process, the Resources Agency identified programs that use the Wildlife Conservation Board's (Wildlife Board) appropriation from the Habitat Conservation Fund (fund) but did not ensure compliance with the spending goals of the California Wildlife Protection Act of 1990 (act). Specifically, the act requires the Wildlife Board to use its appropriation from the fund subject to certain conditions. In each 24-month period, the Wildlife Board must use its appropriation so that specified amounts or percentages of the fund are spent for wetlands; aquatic and riparian habitats; and for deer, mountain lion habitats; and rare or protected species habitats. However, because the Resources Agency decides how the Wildlife Board's appropriation is spent without ensuring that the act's spending goals are fulfilled, the Wildlife Board is unable to spend its appropriation in the proportions necessary to comply with the act.

As a result, more funds have been spent supporting wetlands, aquatic and riparian habitats, and endangered species habitats than intended by the act at the expense of deer and mountain lion habitats.

Background

The act imposes spending goals on the Wildlife Board.

The act specifies that the agencies use money appropriated from the fund to acquire, enhance, or restore various types of habitat. Although, the act requires the Wildlife Board to spend its appropriation subject to certain conditions, it does not impose these same conditions on the other four agencies. These four agencies include the Santa Monica Mountains Conservancy, the Department of Parks and Recreation, the State Coastal Conservancy, and the California Tahoe Conservancy. Specifically, the act requires the Wildlife Board to use its appropriation so that within each 24-month period, the total expenditures of the fund, including the expenditures of the other four agencies, are, to the extent feasible, apportioned accordingly (spending goals):

- Approximately $12 million for the acquisition, restoration, or enhancement of habitat: $6 million designated for wetlands and $6 million for aquatic and riparian habitat.

- Approximately one-third of the remaining moneys for the acquisition of habitat necessary to protect deer and mountain lions and approximately two-thirds for the acquisition of habitat necessary to protect rare, threatened, or fully protected species, as well as for the acquisition of important natural areas.

Adhering to Its Budget Impedes the Wildlife Board's Compliance with Statutory Spending Goals

To receive its appropriation from the fund, the Wildlife Board follows the State's budget process. It submits an initial budget proposal to the Resources Agency for approval. The Resources Agency then submits an approved proposal, with any changes, to the Department of Finance, which relies on the proposal in preparing the Governor's Budget and budget bill that eventually becomes the State's Budget Act.

The Wildlife Board prepares its budget proposal approximately nine months in advance of the budget year, well before the four other agencies use of the fund. However, the Wildlife Board needs actual expenditure information or a projection of actual expenditures from the four other agencies before it can complete a spending plan to fulfill the spending goals for the 24-month period. Because the Wildlife Board is unable to predict where its proposal will fall short of the spending goals, it also submits with its proposal a discussion of the spending goals and a list of potential fund projects to the Resources Agency without specifying how its moneys will be assigned.

The budget process determines how the Wildlife Board's appropriations will be spent, thus impeding its ability to fulfill the spending goals.

For the periods we reviewed, the fiscal years 1992-93 and 1993-94 Budget Acts assigned the Wildlife Board's entire $11 million appropriation from the fund to specific programs and projects, thus, restricting the Wildlife Board's ability to direct moneys to meet the act's spending goals. For example, in the fiscal year 1992-93 Budget Act, the Resources Agency allocated approximately $1.8 million from the California Environmental License Plate Fund to the Habitat Conservation Fund for appropriation to the Wildlife Board. Of this amount, the Budget Act specified that the Wildlife Board use $165,000 for its administrative costs and approximately $1.6 million for

the Department of Fish and Game's Waterfowl Habitat Program and Salmon Habitat Program.

The Resources Agency allocates moneys to the fund in this manner because it wants to ensure it meets the act's requirement that $30 million be transferred to the fund. However, it also wants to ensure that its existing programs continue to be funded. Because the act does not provide additional funding and no General Fund money has been made available for transfer to the fund, the Resources Agency has had to transfer money from its existing projects and programs to meet the $30 million requirement. Although the Resources Agency ensures that these other projects and programs meet the purposes of the fund, it does not ensure that the Wildlife Board's appropriation is allocated in the proportions necessary to fulfill the spending goals. Table 2 shows that during one 24-month period, fiscal years 1992-93 through 1993-94, the Wildlife Board exceeded the spending goals for the wetlands, and aquatic and riparian habitat categories. Further, Table 2 shows that the Wildlife Board did not ensure that one-third (33 percent) of the remaining expenditures were for deer and mountain lion habitat and two-thirds (67 percent) were for rare, threatened, and fully protected species habitat. Rather, 22 percent of the remaining expenditures were in the deer and mountain lion habitat category and 78 percent were for rare, threatened, and fully protected species habitat.

The Wildlife Board exceeded spending goals for wetlands, and aquatic and riparian habitat and underspent on deer and mountain lion habitat.

Table 2

Spending Goals and the Wildlife Board's Use of the Fund During the 24-Month Period: Fiscal Years 1992-93 through 1993-94 (Amounts in Millions)

Habitat Conservation Fund Spending Goals	Fund Use Reported by Other Agencies	Assigned Fund Use for Wildlife Board	Total Use of Fund	Actual Percent of Total	Percent Goals in Act
Approximately $6 million for wetlands	$ 8.3	$4.1	$12.4	N/A	N/A
Approximately $6 million for aquatic and riparian habitat	9.7	5.0	14.7	N/A	N/A
Total	**$18.0**	**$9.1**	**$27.1**	**N/A**	**N/A**
Approximately one-third to acquire deer and mountain lion habitat	$ 7.1	$ 2.7	$ 9.8	22%	33%
Approximately two-thirds to acquire rare, threatened, and fully protected species habitat	24.1	9.8	33.9	78	67
Total	**$31.2**	**$12.5**	**$43.7**	**100%**	**100%**

In accordance with its budget, the Wildlife Board spent $9.1 million in the wetlands and riparian and aquatic habitat categories, even though the other agencies had already fulfilled these spending goals. The Wildlife Board could have achieved all the spending goals, however, if $7.6 million of these moneys had been budgeted for the purchase of habitat for deer and mountain lions and $1.5 million for acquiring rare, threatened, and fully protected species habitat. Table 3 shows how the Wildlife Board could have achieved the spending goals for the remaining fund moneys.

Table 3

How the Wildlife Board Could Have Achieved the Spending Goals During the 24-Month Period: Fiscal Years 1992-93 Through 1993-94 (Amounts in Millions)

Habitat Conservation Fund Spending Goals	Fund Use Reported by Other Agencies	How Wildlife Board Could Have Assigned Fund	Total Use of Fund	Percent of Total
Approximately $6 million for wetlands	$ 8.3	$0	$ 8.3	N/A
Approximately $6 million for aquatic and riparian habitat	9.7	0	9.7	N/A
Total	**$18.0**	**$0**	**$18.0**	**N/A**
Approximately one-third to acquire deer and mountain lion habitat	$ 7.1	$10.3	$17.4	33%
Approximately two-thirds to acquire rare, threatened, and fully protected species habitat	24.1	11.3	35.4	67
Total	**$31.2**	**$21.6**	**$52.8**	**100%**

Because the Resources Agency identified transfers to the fund from moneys that support other non-Wildlife Board programs but did not ensure that the assigned uses of the Wildlife Board's appropriation fulfilled the spending goals, the fund was not spent in the proportions the act specifies.

Recommendations

The Resources Agency and the Wildlife Board should develop a system to ensure that the Wildlife Board's appropriation from the fund is allocated in the proportions necessary to comply with the act's spending goals.

Chapter 3

The Department of General Services Does Not Always Provide Appropriate or Sufficient Guidance in Purchasing Conservation Lands

Chapter Summary

Our review of state land acquisitions for which state agencies used the Habitat Conservation Fund (fund) found that the Department of General Services' Office of Real Estate and Design Services (Office of Real Estate) does not always provide appropriate or sufficient guidance in purchasing conservation lands. The Office of Real Estate is responsible for approving estimates of land values and approving agreements for the acquisition of land. However, for 1 of the 13 state land acquisitions we reviewed, the Office of Real Estate did not protect the State's interest adequately when it purchased land from a nonprofit conservation organization (nonprofit). Specifically, the Office of Real Estate agreed to purchase the land before the nonprofit had acquired the title. Additionally, rather than obtain an independent appraisal, the Office of Real Estate relied on the original owner's critique of the nonprofit's appraisal to approve the purchase price of the land. Consequently, the Office of Real Estate paid approximately $1.8 million more than the nonprofit paid for the land, moneys the State could have used to acquire additional wildlife habitats.

Additionally, the Office of Real Estate does not provide sufficient guidance for state property acquisitions. The Government Code requires the Department of General Services (department) to develop and enforce policies and procedures for property acquisitions. However, we found that the department's Office of Real Estate does not provide state agencies adequate written policies and procedures for property acquisitions, does not effectively communicate changes in its policies and procedures, and does not take the lead in addressing policy changes. As a result, there is no clear statewide policy for real property acquisitions, and departments are sometimes using outdated information.

Background

The Office of Real Estate handles real estate transactions for most state agencies. Although the State's property acquisition law authorizes the Public Works Board to acquire real property on its behalf, this board primarily uses staff from the Office of Real Estate to do so. Additionally, because state law requires the director of the department to approve every contract for the acquisition of real property, the Office of Real Estate manages these matters as well.

The Office of Real Estate offers a full range of real estate services to all state agencies. According to the Office of Real Estate, approximately 26 state agencies can acquire property. Unless exempt, these agencies are required to use certain of the Office of Real Estate's services. For example, for agencies that do not have their own property acquisition staff, the Office of Real Estate handles all aspects of their acquisitions. During the period of our review, only one of the five agencies we reviewed fell into this category, the Department of Parks and Recreation. Agencies that are not exempt and have their own acquisition staff are required to submit their appraisals and acquisition documents to the Office of Real Estate for review and approval. All five of the agencies we reviewed currently fall into this category.

The Office of Real Estate Did Not Adequately Protect the State's Interest for One Acquisition

The Office of Real Estate purchased land for $1.8 million more than the seller subsequently paid.

Our review of 13 state land acquisition projects found that the Office of Real Estate did not adequately protect the State's interest in one case, the acquisition of the Point Lobos Ranch in Monterey County. For this property, the Office of Real Estate did not obtain an independent appraisal but instead established a fair market value based on the original owner's valuation of the land. Further, the Office of Real Estate agreed to purchase the land for $12.9 million from the seller, a nonprofit organization, before the nonprofit had purchased the land for $11.1 million. Consequently, the Office of Real Estate paid approximately $1.8 million more than the nonprofit and as much as $3.9 million more than the land was worth based on the only complete appraisal of the land, the nonprofit's appraisal.

Specifically, the Office of Real Estate approved the purchase of the Point Lobos Ranch from a nonprofit that was in the process of buying the land from a private party and based its price on the private party's opinion. Although the nonprofit's appraiser estimated the value of the land at $9 million, the private party's appraiser critiqued the nonprofit's appraisal and estimated the value of the land at $12.9 million. The appraiser did note,

By relying on a "critique" of the seller's appraisal rather than obtaining an independent appraisal, the Office of Real Estate may have paid $3.9 million more than the property was worth.

however, that the critique was intended to point out valuation issues that require further attention and should not be used as an appraisal. Nonetheless, rather than obtain its own appraisal to independently value the land, the Office of Real Estate appraisal review staff used the critique and recommended that negotiations to purchase the land begin at $12.9 million.

In April 1993, the Office of Real Estate entered into a lease agreement (agreement) to purchase the property from the nonprofit for $12.9 million. This agreement was contingent upon the nonprofit first obtaining title to the land; however, in May 1993, the Office of Real Estate paid the nonprofit the first installment payment of $1.5 million before the nonprofit had title to the land. The nonprofit subsequently purchased the land in June 1993 for $11.1 million, $1.8 million less than the Office of Real Estate agreed to pay approximately two months earlier.

The Office of Real Estate believes it used the nonprofit's appraisal and the private party's critique appropriately to determine fair market value for the land. The Office of Real Estate also believes the initial $1.5 million payment to the nonprofit did not jeopardize state moneys because the nonprofit would not risk tarnishing its reputation with a lawsuit if it did not comply with the terms of the purchase agreement. Further, the Office of Real Estate states that the $1.8 million price differential was reasonable, based upon the claim by the nonprofit's executive director that the excess covered the financial risk should the State be unable to make the installment payments.

However, we believe the Office of Real Estate did not take sufficient precautions to protect the State's interest in several respects. First, given the large disparity in the fair market value between the nonprofit's appraisal and private party's valuation of the land, a more prudent approach would have required the Office of Real Estate to obtain its own appraisal.

Additionally, although the nonprofit may be a reputable organization, we believe the Office of Real Estate should have withheld the first $1.5 million payment or deposited it into an escrow account until the nonprofit received title to the land. Not doing so put the State at risk of paying legal costs to recover the $1.5 million if the nonprofit did not succeed in purchasing the ranch. Moreover, we believe the Office of Real Estate should not enter into any agreement with an entity that facilitates the acquisition of land (facilitator) before the facilitator obtains title to a property and without knowledge of the facilitator's purchase price.

The Office of Real Estate should also consider using a letter of intent, rather than a formal purchase agreement. The United States Department of Interior (federal government) allows federal park and wildlife agencies to provide the facilitator a letter of intent, which identifies the land an agency intends to purchase, the estimated purchase price (subject to future appraisal), and the projected time frame for acquisition. It also states that there is no liability to the federal government if the facilitator does not purchase the land within the specified time. When using a letter of intent, the federal government also requires agencies to have access to the facilitator's records to verify the price, terms, and conditions of land purchased.

Furthermore, we do not believe the nonprofit's $1.8 million gain was reasonable. We do not agree that the State poses a high financial risk because the Department of Parks and Recreation, the agency for whom the Office of Real Estate purchased the land, receives sufficient appropriations from the fund to make the installments. Further, the installment payments include interest charges and the purchase agreement provides for additional fees for late payments, provisions which would compensate the nonprofit for any potential loss.

The Office of Real Estate Does Not Provide Sufficient Property Acquisition Guidance

Because more state agencies directly acquire property, centralized guidance is essential to protect the State's interests.

The Office of Real Estate does not provide sufficient guidance for state property acquisitions. The Government Code requires the department to develop and enforce policies and procedures for property acquisitions. However, we found that the department's Office of Real Estate does not provide state agencies adequate written policies and procedures for property acquisitions, does not effectively communicate changes in its policies and procedures, and does not take the lead in addressing policy changes. As a result, there is no clear statewide policy for real property acquisitions, and agencies are sometimes using outdated information.

The Government Code recognizes the importance of centralizing certain functions and services to take advantage of specialized skills and techniques, to provide uniform management practices, and to ensure a high level of efficiency and economy. This code also requires the department to develop and enforce policies and procedures for state property acquisitions.

Because a growing number of state agencies conduct their own property acquisition activities, centralized guidance is essential to ensure that the State's interests are adequately protected. Written policies and procedures ensure that state agencies receive

consistent guidance. Further, to ensure they are properly implemented, these policies and procedures (along with information that affects them) must be communicated effectively and disseminated promptly to state agencies. We believe it is the Department of General Services' (department) responsibility to take the lead in setting and communicating statewide policy.

The department removed detailed policies and procedures from SAM without providing an adequate replacement.

During our period of review, fiscal years 1992-93 through 1994-95, the department's property acquisition policies and procedures were spelled out in the State Administrative Manual (SAM). However, in June 1996, the department removed the detailed policies and procedures from the SAM. Although the current SAM states that the Office of Real Estate provides procedures for agencies to use, when we requested copies of these procedures, it was unable to provide them. Consequently, its current requirements are unclear.

For example, until June 1996, the SAM required that all appraisal reports be reviewed before state agencies commenced negotiations to purchase property. Although this requirement has been deleted from the SAM, the Office of Real Estate still requires state agencies to have their appraisals reviewed. We asked the Office of Real Estate how state agencies would know to submit their appraisals for review. According to the Office of Real Estate, state agencies know this is required because it has been required for years. Furthermore, the Office of Real Estate stated that if an agency failed to submit its appraisal for review before it started negotiations, it would be required to do so before its acquisition was approved by the Public Works Board. Although this approach may work now when agencies are accustomed to the appraisal review practice, the department cannot rely on practice and memory to protect the State's best interest. Since the purpose of the appraisal is to ensure that the State pays the appropriate price for the property being acquired, it is important that the department provides the guidelines and processes to ensure this review takes place before negotiations begin so that state agencies have a firm basis from which to negotiate.

Additionally, the Office of Real Estate does not provide consistent guidance to state agencies. For example, we requested the Office of Real Estate to provide us with its standard contract for hiring appraisers. However, the contract it provided was outdated. The Office of Real Estate's current contract to hire appraisers requires an appraisal report that conforms to the Uniform Standards of Professional Appraisal Practice and the Code of Professional Ethics and Standards of Professional Appraisal Practice of the Appraisal Institute (professional appraisal standards). If the Office of Real Estate had an up-to-date procedures manual that included standard forms, it could have provided us with its most current contract. Furthermore, our survey of the five agencies in our audit disclosed

that four still use the outdated contract. Because the old contract does not require that appraisals be prepared to conform to professional appraisal standards, state agencies using the outdated contract are not taking advantage of the additional level of assurance this requirement provides.

Agencies are unclear about available options and have incurred additional costs because the department has not communicated policy changes.

Furthermore, the Office of Real Estate is not effectively communicating policy changes to state agencies. For example, before June 1996, the SAM required state agencies to offer fair market value (FMV) for property acquisitions. This requirement was based on Government Code, Section 7267.2, which requires public entities to pay just compensation to landowners to acquire property. However, in an April 1993 Court of Appeals (court) case, *Melamed vs. City of Long Beach*, the court found that Government Code, Section 7267.2, applies only when the government is acquiring land through eminent domain. The court held that Section 7267.2 was not applicable to ordinary purchases of land by public agencies. Although the Office of Real Estate chooses to continue to offer FMV for all its land acquisitions, it no longer requires state agencies performing their own acquisitions to do so. However, because the Office of Real Estate has not communicated this policy change, four of the five agencies we reviewed believe the offer of FMV is still a legal requirement. Furthermore, because the Office of Real Estate has not provided the information and guidance to state agencies, two of the five agencies have incurred additional legal expenses to determine how the court's decision may affect their land acquisition practices. We believe that the Office of Real Estate should have taken the lead in obtaining a legal opinion and informing state agencies of the options available to them.

Recommendations

To protect the State's best interest when acquiring conservation lands, the department should:

- Prohibit the execution of purchase agreements with organizations or individuals that do not own the land being acquired; consider using letters of intent similar to those used by the federal government.

- Require individuals or organizations that facilitate land acquisitions to fully disclose the price and other terms and conditions of their land acquisitions before the department agrees to a purchase price.

- Develop and distribute written policies and procedures for other state agencies that acquire real property to ensure consistency in state land acquisitions. If the department does not pursue its role as a statewide policysetter, the Legislature should direct the Department of General Services to set these policies.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. We limited our review to those areas specified in the audit scope of this report.

Respectfully submitted,

Kurt R. Sjoberg

KURT R. SJOBERG
State Auditor

Date: April 21, 1997

Staff: Sylvia L. Hensley, CPA, Audit Principal
Robert Cabral, CIA
Craig W. Feight
Doris Jensen

The Resources Agency of California

Pete Wilson
Governor

Douglas P. Wheeler
Secretary

California Conservation Corps • Department of Boating & Waterways • Department of Conservation
Department of Fish & Game • Department of Forestry & Fire Protection • Department of Parks & Recreation • Department of Water Resources

April 16, 1997

Kurt R. Sjoberg
California State Auditor
Bureau of State Audits
660 J Street, Suite 300
Sacramento, California 95814

Dear Mr. Sjoberg:

Subject: Habitat Conservation Fund Audit Number 95110

While we were pleased to read your conclusion on page S-1 "...that agencies generally complied with the act...", the report contains some inaccuracies regarding the allocation of resources into and expended from the Habitat Conservation Fund (HCF). The Santa Monica Mountains Conservancy and the State Coastal Conservancy have each responded to you findings in separate letters. This response is intended to incorporate those and more specifically, relates to comments regarding the Resources Agency, the Department of Fish and Game and the Wildlife Conservation Board (WCB).

First of all, on page 2-1, the auditors indicate that the Resources Agency decides how the WCB appropriation is spent without ensuring that the Act's spending goals are fulfilled and that, therefore, the WCB was unable to spend in accordance with the proportions set forth in the Act. While the Board's flexibility may have been affected to a minor extent by the necessary earmarking of select funds, it is contended that the Board did fully comply "to the extent practicable", as required, by the Act. 1*

It should be kept in mind that the Act appropriates $30 million annually from a fund which does not have $30 million of annual revenues. The Controller is required to transfer any appropriation shortfall from the General Fund. This condition required the applicable entities of the Resources Agency into proposing to the Legislature a variety of measures to reach the $30 million funding requirement, without impact to the General Fund. Basically, this was accomplished by using funds from other agencies that were committed to programs which qualified under the goals of the Act.

The Resources Building Sacramento, CA 95814 (916) 653-5656 FAX (916) 653-8102

California Coastal Commission • California Tahoe Conservancy • Colorado River Board of California
Energy Resources, Conservation & Development Commission • San Francisco Bay Conservation & Development Commission
State Coastal Conservancy • State Lands Commission • State Reclamation Board

*The California State Auditor's comments on this response begin on page 39.

On page 2-3, the report erroneously states that "The Resources Agency transfers moneys to the fund...". The Agency has no such authority. These funds (2) were transferred through appropriation by the Legislature, via the WCB's budget with language that these funds, together with their programs, be made available to the agency from which the funds were originally derived. While the funding goals were not precisely accomplished through this action, we and the Legislature were able to meet the requirements within the intent of the law and certainly "to the extent (1) practicable" as required in Section 2791.

Based on these transfers the report comes to the conclusion in Chapter 2, page 2-1, that the WCB "could not" make expenditures or was "unable to spend" in compliance with the Act because of circmstances beyond its control, which the auditors have interpreted to be a strict one-third, two-third split in the spending goals. However, on pages S-2 and 2-5, the report states the WCB "did not spend" the appropriation in compliance with the spending goals of the Act. If compliance based on strict interpretation of the spending goals is concluded to be appropriate, then the statements made on pages S-2 and 2-5 should be modified to agree with the (3) statements made on page 2-1.

The audit indicates on page 2-1 (Background) that only the WCB was subject to (4) the condition of meeting given appropriations in each 24 month period. We do not fully support this conclusion and by letter dated June 27, 1991 to the organizations funded from the HCF, the Resources Agency requested that all fund recipients meet these requirements, again, to the extent practicable. (1)

As to the issue of how to judge compliance, the auditors determined that compliance with the Act requires a strict one-third, two-third split on the total expenditures from the Fund. We believe that the Act clearly envisioned that the individual funding splits were general guidelines only, since in every section detailing the fund expenditure splits, the words "to the extent practicable" were added. The (1) strict interpretation conclusion by the audit does not take into account the information provided to the auditors regarding the policy and law requirements relative to land acquisitions and enhancement projects undertaken by the WCB. The authors of the initiative were aware that the State agencies named in the Act operate under a policy of "willing-landowners" only conditions. While each agency maintains a large list of proposed transactions, these lists are constantly changing due to a variety of conditions, including landowner interest and property values. The ability of the WCB

to substitute a project when negotiations for another project fails in order to fill a certain spending goal is not easy, and could certainly impact the Board's ability to meet the funding goals when a project fails near the end of a 24-month reporting period.

Many elements must be considered by each agency spending the Fund to determine selection besides the spending goal, including willing-landowner, cost and management needs. In fact, the auditors recognized the difficulty in predicting what spending goal will be achieved on page 2-2 of the report. We believe the authors of the initiative had a full understanding of these limitations on potential projects to be funded and purposefully built in room for the spending goals to change and not be strictly interpreted when they added the language "to the extent practicable" 1
in Section 2791 of the Act.

In addition, the audit report did not adequately explain that the WCB prepares the required 24-month report summarizing each project by the prominent resource or resources being protected. In essence, features do not exist in isolation from each other in the natural environment. Thus, an acquisition made for the purpose of protecting threatened and endangered species-habitat, may also provide protection of wetland, deer and mountain lion habitat and riparian habitat. In fact, multi-habitat protection is more often accomplished, rather than single-habitat type protection. It would take an enormous amount of staff time and biological expertise to break down each resource protected by acre and dollar amount in every project, which is why it is not done initially. In some cases, two or more resource categories are identified for an individual project, usually by assigning a rough percentage estimate, but more often, no individual counts are made. If one considers that many acquisition and enhancement projects involve hundreds of acres, it is understandable why this is a difficult task. This would also be a cumbersome, costly procedure and frankly would serve no real value since we believe the intent of the Act is being met.

The decision to identify the prominent resource being protected was, therefore, done in part because of the difficulty involved and also because the Act provides in no less than four places, that the expenditures were to be made "to the extent 1
practicable" by particular categories. Every attempt was made to comply with the Act. Certainly having the budget process identify some of the money for specific programs not under the Board's control, reduced the ability of the Board to direct those expenditures. However, the programs chosen for transfers were carefully selected to comply with the intent of the Act as stated in Section 2786 a-f.

These conditions were fully explained to the auditors. For the draft report to say
that a 22-78 percent ratio of expenditure rather than a 33-66 percent ratio is not in
compliance, is inappropriate since the WCB did fulfill the conditions of the Act "to the 1
extent practicable." Also, to state on page 2-4 that the WCB could have achieved the
spending goals is not necessarily true. Rather, given the conditions of the Act that
require a variety of funding splits among resources categories, agencies, and
portions of the State, the audit should reflect the difficulty of the task presented to the
Resources Agency and the WCB, and how closely compliance was achieved within
the intent of the Act, especially in times of limited bond funds and severe economic
recession for the State.

On a different subject, the report indicates on page Int-6, that the Department of
Fish and Game did not maintain current Conflict of Interest Codes and did not
properly identify employees who were required to file an annual State of Economic
Interest. This is, in fact, an untrue statement. The Department does have Conflict of 5
Interest requirements that do identify employees that are required to file annual
statements. Perhaps it would have been more appropriate to indicate that the
auditors do not agree with the existing requirements and would recommend that
additional employees be required to file the annual statement.

Finally, the audit recommended that "the Resources Agency and the WCB
should develop a system to ensure that the WCB's appropriation from the fund is
allocated in the proportions necessary to comply with the Act's spending goals." As
has repeatedly been pointed out in the above response, it is felt that the goals were in
fact fully met, as required by the Act. It must be reiterated that, keeping in mind all the
variables one incurs when managing the Habitat Conservation Fund, especially as it
relates to land acquisitions, meeting the precise one-third, two-third ($6 million-$6
million) breakdown is probably impossible, but we continue to meet these spending 1
goals "to the extent practicable."

Sincerely,

for Douglas P. Wheeler
Secretary for Resources

Comments

California State Auditor's Comments on the Response From the Resources Agency

To provide clarity and perspective, we are commenting on the Resources Agency's response to our audit report. The numbers correspond to the numbers we have placed in the response.

1 We do not dispute that the California Wildlife Protection Act of 1990's (act) restrictive requirements are difficult to meet; however, we believe the Resources Agency did not ensure compliance with the act's spending goals "to the extent practicable." Specifically, during the budget process when the Wildlife Board presents its budget proposal to the Resources Agency, it requests that its entire appropriation be provided without earmarking the funds for a particular use. However, the Resources Agency does earmark the use of the Wildlife Board's appropriation. As a result, the Wildlife Board cannot comply with the spending goals. This is inconsistent with the Resources Agency's contention that the Wildlife Board's flexibility has only been affected to a ***minor extent***. In fact, the Resources Agency's earmarking of selected funds has precluded the Wildlife Board from complying "to the extent practicable," as required by the act.

Further, as we state on pages 23 and 24, although the Resources Agency ensures that $30 million is transferred to the fund, it does not ensure that the Wildlife Board's appropriation is allocated to fulfill the spending goals. This resulted in the fund being overspent in the wetlands, aquatic and riparian habitat categories at the expense of the deer and mountain lion, and rare, threatened, and fully protected species categories.

2 Text on page 22 changed from "transferred" to "allocated" and on page 23 from "transfers" to "allocates."

3 Text on page S-2 changed from "did not spend" to "could not spend."

4 The background discussion in the report is not our conclusion, but rather, reflects the conditions the act imposes on the Wildlife Board's use of its appropriation from the fund.

5 Our review of the Department of Fish and Game's November 1986 conflict-of-interest code, which includes the Wildlife Board, found that the department's code is outdated. Specifically, certain Wildlife Board positions that should be included in the code are not. The Wildlife Board's executive director communicated these positions to the department in a May 1995 memorandum entitled "Positions to be designated in the Department's Conflict of Interest Code."

SANTA MONICA MOUNTAINS CONSERVANCY
STREISAND CENTER FOR CONSERVANCY STUDIES
5750 RAMIREZ CANYON ROAD
MALIBU, CALIFORNIA 90265
PHONE (310) 589-3200
FAX (310) 589-3207

April 16, 1997

Mr. Kurt R. Sjoberg
State Auditor
660 "J" Street, Suite 300
Sacramento, California 95814

Response to Habitat Conservation Fund Audit

Dear Mr. Sjoberg:

Attached is our formal response to the Habitat Conservation Audit. We strongly disagree with the audit's major conclusions.

The points we have made in our response are not new. They are the same points that our staff has made to your auditors throughout this past year. We are especially disappointed that your auditors did not accept the Attorney General's legal opinions, when under Government Code Section 11157 we are obliged so to do. 1*

The audit's recommendations for more and better paperwork, where appropriate, will be implemented.

While we have disagreed with the position taken by your audit staff, they were unfailingly professional and courteous.

Sincerely,

Elizabeth A. Cheadle

ELIZABETH A. CHEADLE
Chairperson

JOSEPH T. EDMISTON, AICP
Executive Director

*The California State Auditor's comments on this response begin on page 63.

STATE OF CALIFORNIA—THE RESOURCES AGENCY PETE WILSON, Governor

SANTA MONICA MOUNTAINS CONSERVANCY
STREISAND CENTER FOR CONSERVANCY STUDIES
5750 RAMIREZ CANYON ROAD
MALIBU, CALIFORNIA 90265
PHONE (310) 589-3200
FAX (310) 589-3207

Response to Habitat Conservation Fund Audit

April 16, 1997

THE AUDIT IS WRONG IN ITS PRINCIPAL CONCLUSION AND GIVES SHORT-SHRIFT TO THE CRITICALLY NEEDED LAND ACQUISITIONS FUNDED BY PROP. 117

As this response will amply demonstrate, the audit's lead conclusion is just plain wrong when it says that the Santa Monica Mountains Conservancy (SMMC) "spent more habitat conservation funds than necessary to conserve lands" because it paid interest on promissory notes. 2

THE PAYMENT OF INTEREST IS A NECESSARY AND LEGITIMATE COST OF PARTICIPATING IN THE REAL ESTATE MARKET. The audit would have the SMMC risk losing critically needed lands rather than incur interest payments, waiting instead until the full amount of the purchase price is in hand before entering the transaction. This would, quite simply, prevent the purchase of some major, environmentally sensitive, properties that come on the market in the Santa Monica Mountains.

AS A RESULT OF USING PROMISSORY NOTES THE SMMC WAS ABLE TO SPREAD ITS LAND ACQUISITION DOLLARS OVER A WIDER AREA. The audit criticized two promissory note transactions entered into in 1991. What the audit didn't say was that SMMC entered into a record 32 transactions during calendar 1991 totaling 3819 acres (sixteen Habitat Conservation Fund projects and another sixteen from Proposition 70 Bond funds). This record achievement would not have happened without purchasing Paramount and Towsley on terms.

THE DECISION TO USE PROMISSORY NOTES WAS RATIONAL, MADE BY AN ACCOUNTABLE BOARD, UPON SOUND LEGAL ADVICE, AND MADE BY QUALIFIED INDIVIDUALS WHO BALANCED RISKS AND BENEFITS. Auditors and CPAs, as highly qualified as they may be in their respective disciplines, are not trained nor are they qualified to make difficult decisions in conservation biology and natural resource management. All resource lands are not equally fungible. The old real estate adage about "location, location, location" holds true in the world of conservation biology.

The SMMC is governed by a broadly representative board consisting of (1) the Secretary of the Resources Agency, (2) Director or designee of the National Park Service, (3) a member of the Los Angeles County Board of Supervisors, (4) a member of the Ventura County Board of Supervisors, (5) a member appointed by the Mayor of Los Angeles, (6) a member appointed by the Assembly Speaker, (7) a member appointed by the Senate Rules Committee, and (8) a member appointed by the Governor. On coastal zone items the *ex officio* member representing the Coastal Commission may vote.

The Conservancy/Mountains Authority staff contains over 42 person-years worth of advanced degree professional experience in biology, resource management and related fields, and 50 person-years worth of professional real estate and land acquisition experience.

SMMC followed the mandate of the Wildlife Protection Act (Prop. 117) and responded to the "urgent need" to protect habitat, making full use of all available tools

The SMMC took the path that committed the most land to acquisition in the shortest time. In doing so, it followed the Wildlife Protection Act's finding of "the *urgent* need to protect the rapidly disappearing wildlife habitats . . . . [Section 2780(a), italics added]"

That section goes on to give explicit direction that:

> This chapter [Wildlife Protection Act of 1990] shall be implemented in the most expeditious manner. *All state officials shall implement this chapter to the fullest extent of their authority* in order to preserve, maintain, and enhance California's diverse wildlife heritage and the habitats upon which it depends. (Subdivision (e), italics added.)

Section 2797(a) of the measure, the section specifically referencing SMMC, reiterated the need to "acquire, restore, and improve the *rapidly disappearing* wildlife habitat of southern California" [italics added].

It is important to keep these sections of the Wildlife Protection Act firmly in mind because nowhere in the audit is there any hint of the urgent necessity that brought this citizens' initiative to a vote in November 1990 General Election and sustained it against an attempt at partial repeal in 1996.

As the quoted sections make clear, the people voted because there was an *"urgent need,"* to be dealt with by the delegated officials using *"the fullest extent of their authority"* in order to protect *"rapidly disappearing wildlife habitat"* in Southern California.

SMMC capitalized on an uncertain real estate market to protect the greatest number of parcels from development

The two transactions that gave rise to the "more money spent" criticism, Paramount Ranch and Towsley Canyon, were entered into in 1991. That year was an uncertain time for Southern California real estate, sluggishness in the market meant that unanticipated opportunities were becoming available, many of them long sought-after habitat lands with previously unwilling sellers. Some of them were one-time opportunities; all of them shared the characteristic that SMMC could be out-bid in the event of a market turn-around.

In a nutshell, SMMC faced a situation of too many vitally needed projects chasing too few dollars. Deferring purchases would mean risking loss of a project with a willing seller. On the other hand, if the Conservancy could find a method of securing the land immediately then *all* of the Conservancy's highest priorities for that year could be protected.

SMMC opted for the latter strategy. By awarding grants to its cooperating joint powers authority, the Mountains Recreation & Conservation Authority (Mountains Authority) was able to use promissory notes secured by deeds of trust to tie down two properties, Paramount Ranch and Towsley Canyon, the outright purchase of which—at a total of $18,000,000—would have sacrificed all but a few of the other priority land acquisitions the SMMC was contemplating. (See Attachment "B" for list of the SMMC's 1991 projects.) *

The audit is deficient in not counting lost acquisition opportunities as an offset against interest costs incurred 2

What is most striking about the audit, from a professional standpoint, is the simplistic approach taken to the Los Angeles-Malibu real estate market, arguably one of the most sophisticated in the world. Totally ignored in the 12 pages of the audit document devoted to SMMC is any discussion whatsoever of the *opportunity cost* of investing the entirety of the SMMC's capital available during calendar 1991 in a relative few all-cash transactions.

*We have not included this attachment in the report; however, it is available for review at the Bureau of State Audits.

The opportunity cost in 1991 of adhering to the audit recommendation would exceed benefit by almost a 5:1 ratio

Had the SMMC done in 1991 what the audit suggests in 1997—namely paying all cash for Paramount and Towsley—it could have only acquired a total of between 1100 and 2000 acres (depending on the project mix) instead of the 3819 acres actually protected. At the very minimum 1,800 acres would *not* have been protected in 1991 and would have been put at risk of permanent loss.

This calculation of opportunity cost, at the average value of transactions entered into during calendar 1991 of $5598 per acre, means that opportunity costs would have exceeded benefit by almost a *five to one ratio* ($2,200,000 interest cost *vs.* roughly $10,100,000 worth of land not protected).

THE SMMC EXERCISED APPROPRIATE JUDGMENT WHEN IT FOUND THE CRITICAL RESOURCE VALUES OF PARAMOUNT RANCH AND TOWSLEY CANYON OUTWEIGHED THE INTEREST COST

The audit is deficient because it does not give credit to SMMC for weighing the wildlife habitat benefits of specific land acquisitions against the cost of accruing interest. The blanket statement that "[interest on promissory notes] could be better used to acquire land" (p. 1-4) ignores the reality that different lands have different resource values. If the SMMC had incurred interest costs for marginal or unworthy land then the audit might have a case. But it is surprising to find the SMMC's judgment criticized when the audit does not dispute—nor could it—that Paramount Ranch and Towsley Canyon acquisitions had to be concluded in 1991 or they would have been lost; that acquiring these lands was essential to carrying out the Wildlife Protection Act's intent, and that the most environmentally significant lands were being protected. 2

Paramount Ranch Acquisition:

Interior Secretary Bruce Babbitt himself accepted transfer of Paramount Ranch from the SMMC to the National Park Service. This property, known to millions as the former site of the Renaissance Pleasure Faire in Agoura, was described by the Secretary as, "Rich in wildlife, history and natural beauty," the acquisition he said "is integrally related by landform and visual character" to existing National Park lands, and "will provide a critical

link to the Zuma Ridge Trail, which connects with Malibu Creek State Park." (*Malibu Times,* April 6, 1995.)

Paramount Ranch was the subject of an approved 150 unit subdivision, litigated for over two years by the Sierra Club and ultimately affirmed. In February 1989, based on an approved appraisal, the SMMC offered $21,000,000 and was rebuffed by the developer. So important was Paramount Ranch that the SMMC considered condemnation of the property but ultimately declined to go forward because independent condemnation counsel (retained with approval of the Attorney General's Office) estimated a likely jury award between $25,000,000 and $31,000,000 (*Hill, Farrer & Burrill Memorandum*, March 15, 1989, p. 2). The Attorney General estimated between $30,000,000 and $40,000,000 to acquire by condemnation (*California Department of Justice Memorandum*, March 21, 1989, p. 4).

These documents prove that the $18.5 million paid for Paramount Ranch was $2,500,000 *less* than the Conservancy's offer of 1989 (based on an approved appraisal)and $6,500,000 *less* than the lowest estimate of a condemnation award. 3

Only the tragic death of the landowner Ezra Raiten in a small plane crash, and the cross-collateralization of Paramount Ranch with other holdings of the Raiten estate, allowed the SMMC to negotiate directly with the underlying note holder which was Union Federal Savings Bank. The bank was itself in a precarious enough situation that it rushed to heavily discount the note rather than show a nonproductive asset to the RTC. The SMMC had to act quickly because once Raiten's estate reorganized, which it did, the opportunity for the purchase would be gone. The landowner's death was an unexpected event that could not be planned for in advance in scheduling out the SMMC's acquisition plans (as we have seen condemnation would have been too expensive). So the SMMC had no choice but to use a technique that spread the payment out over future years when National Park Service and ultimately future HCF monies would be available.

All of this was played out in the press and was amply documented by news coverage at the time. (See, e.g., *Los Angeles Times,* Valley Ed., June 28, 1991 and preceding stories by *Times* staff writer Myron Levin who first brought to light the labyrinthian complexities of the Raiten estate.)

The story of how the SMMC got this fervently desired property, just when all hope seemed lost after the court case was lost and the purchase offer refused, is an object lesson in the need for flexibility and access to a wide-range of land acquisition tools—precisely the characteristics, of course, that SMMC brings to the table.

Towsley Canyon (Brandon) Acquisition:

The Towsley Canyon (Brandon) purchase protected 273 acres in the center of Towsley Canyon in the Santa Clarita Woodlands Park within the Santa Susana Mountains. It is characteristic of this audit that it criticizes the acquisition without any reference to the natural values secured and protected by it. 2

The *Santa Clarita Woodlands Feasibility Study* conducted by the Department of Parks and Recreation (1990) noted that Towsley Canyon contains:

> Plant communities . . . which are endangered, according to the California Department of Fish and Game. These include the California walnut and valley oak woodlands. Other communities are rare. . . . The area has at least 21 distinct plant communities.

Dr. Todd Keeler-Wolf, vegetation ecologist for the Department of Fish and Game's Natural Diversity Database, in a letter to Senator Ed Davis urging protection for the property, said that Towsley Canyon has "a number of unique or near-unique vegetation types I have not seen elsewhere in the state."

But in 1991 Towsley Canyon was threatened. The canyon was identified as a high priority acquisition by the SMMC, but the Los Angeles County Sanitation Districts had already purchased options on the surrounding 1,500 acres and desired to fill the entire canyon for a sanitary landfill (*Los Angeles Times,* Valley Ed., April 5, 1991).

This was a well known public issue, as early as June 18, 1990 the *Daily News* headline was: "Race is on to buy Towsley Canyon land: Santa Monica Conservancy, sanitation districts in bidding war." In an article headlined, "Towsley Canyon offer dropped: Conservancy outbid by county sanitation officials who want site for landfill" the *Daily News* reported on October 18, 1990 that the Sanitation District offered the owners in excess of $4,000,000 for their property, subject to contingencies.

In order to acquire the property the SMMC had to make a no-contingency offer, especially because the appraised value of $2.5 million—the SMMC ceiling price—was significantly below the Sanitation District offer.

Again, the Mountains Authority was able to step-in using the note and deed of trust method and consummate the acquisition, thus saving the canyon from the possibility of becoming a landfill. As the *Los Angeles Times* reported: "Los Angeles County sanitation

officials acknowledged that the move by the conservancy—a state parkland acquisition agency—effectively blocks development of a dump in Towsley Canyon . . . ." (*Ibid.*, p. B-3)

The Santa Monica Mountains Conservancy/Mountains Authority was lauded by the community for wrestling the land away from the Sanitation District, in a comment reflective of most public reaction, the *Los Angeles Times* reported, "'The Los Angeles County Board of Supervisors would fill in Yosemite if it could.' [State Senator Ed] Davis said. 'Now Towsley Canyon will remain a natural beauty spot.'" (*Ibid.*)

CONSERVING LAND BY PROMISSORY NOTE AND DEED OF TRUST IS PRUDENT, LEGAL, AND IS GOOD PUBLIC POLICY WHEN CRITICALLY NEEDED HABITAT MUST BE ACQUIRED 4

When a business or individual in the private sector must make an acquisition in order to fulfill important obligations (such as providing housing for your family, or buying land for a new factory) there is *one* tried and true way that virtually everybody uses. Land is purchased on time secured by a deed of trust. Since time is money, interest is charged. This bedrock of virtually every private real estate transaction, is somehow shockingly new to the auditors (well-intentioned and earnest though they may be) and causes them to conclude 2 that—because of interest payments—SMMC spent $2.2 million more HCF money than necessary.

The audit is deficient in not comparing and contrasting different land acquisition techniques before criticizing SMMC's use of promissory notes

The audit is misleading because it criticizes promissory notes without analyzing the financial and policy implications of *other tools* the propriety and legality of which nobody questions, but which are *financially and environmentally inferior* to the use of promissory notes secured by deeds of trust.

Had the audit looked at options (which are specifically mentioned within the enumerated powers in Public Resources Code Sec. 33203) and compared and contrasted them to the use of promissory notes it would have concluded—as did SMMC—that promissory notes are a superior method of achieving environmental land acquisitions. The audit having failed to look at both sides, we will now do so:

Promissory notes secured by deed of trust are superior to options as a method of trading a small amount of money for a longer time to pay

As we have seen, public agencies sometimes cannot afford to pay the entire purchase price at one time for a parcel of land that needs to be protected. Public agencies, like individuals and business, sometimes need to trade a little money for a longer time to pay. There are two ways of doing this: (1) buying an option, which grants the right to purchase the property in the future for a set price, or (2) giving a promissory note secured by deed of trust in which ownership transfers to the buyer immediately in return for a down payment.

OPTIONS TYPICALLY COST MORE TO A PUBLIC AGENCY THAN AN EQUIVALENT NOTE TRANSACTION. The typical commercial option runs about 10% of market value per year. The option can be deductible from the purchase price (a 'free option') but almost always the price of an option is *on top of* the sale price. If the option holder does not exercise the option within the set time period, all value to the option is lost and the landowner is free to sell the land to whomever.

NOTE AND DEED OF TRUST IS SUPERIOR TO AN OPTION BECAUSE OWNERSHIP VESTS IMMEDIATELY. The Conservancy/Mountains Authority can enjoy use and control of the property (which is important for public recreational access purposes and habitat management), while the seller is relieved of public liability and property taxes—which do not accrue to a public agency.

LANDOWNERS ALSO FAVOR THE NOTE AND DEED OF TRUST APPROACH AND ARE WILLING TO AGREE TO MUCH MORE FAVORABLE TERMS THAN AN OPTION. The Paramount Ranch transaction is a case in point. For a down payment of *less than 3.25%* the Mountains Authority was able to secure a $15,500,000 transaction. An outright sale, even secured by note and deed of trust, has better tax consequences for most landowners than taking an option, and this is another reason sales are preferred. 5

ENVIRONMENTALLY THE NOTE AND DEED OF TRUST IS BETTER BECAUSE HABITAT RESTORATION AND PROTECTION CAN BEGIN IMMEDIATELY. Paramount Ranch is again a case study: the previous landowner allowed motorcycles, homeless encampments, trash, and the casual storage of hazardous materials. When Conservancy/Mountains Authority assumed ownership it immediately shut down the offending uses and began restoration of the property with the help of the National Park Service. This would not have been possible had SMMC only secured an option.

The SMMC undertakes no greater risk when it acquires property on terms 6

When the Mountains Authority purchases parkland on terms it pays a portion of the purchase price at the time the deed is recorded and gives the seller a promissory note secured by a deed of trust recorded against the property for the balance of the purchase price. This type of promissory note secured by a deed of trust is called a purchase money note.

If the balance of the purchase price is not paid the seller has only one remedy. This solitary remedy is the right to take back the property. The seller cannot sue to collect on the promissory note even if the property is not worth the balance of the purchase price due to the seller. This law has been codified at Section 580b of the California Code of Civil Procedure, which provides:

> No deficiency judgment shall lie in any event after any sale of real property for failure of the purchaser to complete his contract of sale, or under a deed of trust, or mortgage, given to the vendor (seller) to secure payment of the balance of the purchase price of real property.

Every type of property—from single family residences to large parcels of open space—is covered by the protection of C.C.P. Sec. 580b. In addition, California's "security first rule" prohibits the seller's waiving the security and suing on the note to obtain a personal judgment against the seller. *Bank of Italy Nat. Trust & Savings Assn. v. Bentley* (1933) 217 Cal. 644.

To summarize, a seller who takes back a promissory note secured by a deed of trust for the balance of the purchase price must look to the property in the event of a default and cannot sue for a deficiency.

If the Mountains Authority fails to make the final payment, *a situation that has never happened*, the loss is limited to the down payment and periodic interest payments, if any. The outcome would be the same if the Mountains Authority or Conservancy acquired an option to acquire. If the option is not exercised the option payment is lost.

Options are, in fact, more costly for the State because the seller agrees to hold the property for the duration of the option term for the buyer and bears all the costs associated with

ownership and management of the property during the term of the option. The seller would want to recover these costs, whereas the seller does not have to consider these costs when the property is sold on terms.

The Mountains Authority has power to acquire real property interests by promissory note and deed of trust 4

Nobody disputes that the State Public Works Board may purchase land on terms (Government Code Sec. 15854.1), nor is it disputed that the Conejo and Rancho Simi recreation and park districts (who are the constituent partners with SMMC in the Mountains Authority) may do so. See subdivision (g) of Public Resources Code Sec. 5782.5.

The audit, however, questions whether the SMMC has the power to purchase land on terms, and if it doesn't, so the reasoning goes, then there is no unity of powers between the contracting agencies, so *ergo* the Mountains Authority lacks such power.[1]

The Attorney General's Office says the Mountains Authority has the power to purchase by promissory note and deed of trust (see memorandum opinions from Deputy Attorney General Allan Hager, Attachments "A-1" and "A-2"), the Mountains Authority counsel * in 1991 issued an opinion letter validating the Paramount Ranch transaction, specifically the power to purchase by note and deed of trust, and current Conservancy and Mountains Authority counsel has addressed this issue in *four* separate letters to Bureau of State Audits staff members. Moreover, the Mountains Authority has been sustained by the Superior Court on the critical issue called out by the audit, i.e., the interpretation of subdivision (e) of Public Resources Code Sec. 33207.5.

---

[1]This argument is fallacious *ab initio* because it conflates the existence of a power, i.e., the ability to acquire land, which indubitably belongs to SMMC and its recreation and park district partners, with the "manner in which the power will be exercised" which is to be determined in the joint powers agreement itself (Government Code Sec. 6503). Pursuant to Government Code Sec. 6509, the Mountains Authority JPA determined that the "manner of exercising the power" was that of the local recreation and park district members (JPA Agreement, Sec. 4.2) who have the explicit authority to purchase land on time (see Public Resources Code Sec. 5782.5 cited above).

*We have not included these attachments in the report; however, they are available for review at the Bureau of State Audits.

The *only* backing for this contention is an anonymous opinion—to which SMMC staff counsel was denied access—done by a private attorney hired by the Bureau of State Audits.[2] 7

The power to acquire property is a power common to each of the members of the Mountains Authority

Public Resources Code Sec. 33203 provides in relevant part that

> The conservancy may acquire, pursuant to subdivision (e) of Section 33207.5 and the Property Acquisition Law (Part 11 (commencing with Section 15850) of Division 3 of Title 2 of the Government Code), real property or any interest therein . . . for all the purposes specified in this division.

Those powers, manners and methods necessary to carry out the Conservancy's mandate to acquire parkland within its zone are necessarily implied in the power to acquire.

Public Resources Code Sec. 33207.5(e) provides in pertinent part that

> notwithstanding the provisions of the Property Acquisition Law (Part 11 (commencing with Section 15850) of Division 3 of Title 2 of the Government Code), and any other provision of law, the executive director of the

---

[2]We observe *passim* that while the Bureau of State Audits is entitled to look at every paper in the SMMC's possession (Government Code Sec. 8545.2), the staff of the Bureau has, to date, refused the SMMC's counsel's request to see whatever opinion was rendered by the anonymous private attorney. Such refusal appears to violate Government Code Sec. 8545 which provides, in relevant part, that: "All books, papers, records, and correspondence of the bureau pertaining to its work are public records subject to [the California Public Records Act]." The only relevant exception is in subdivision (a) of Sec. 8545, "[p]ersonal papers and correspondence of any person receiving assistance from the State Auditor when that person has requested in writing that his or her papers and correspondence be kept private and confidential." Whether the auditor's private attorney is a "person receiving assistance from the State Auditor" is debatable, but even more questionable is the Bureau's decision not to make the attorney's actual opinion subject to peer review, especially since it is the only leg they have to stand on for a major portion of the audit. 7

> conservancy may take such actions as necessary to carry out the provisions of this *division*." [Emphasis added.]

The auditor disagrees with SMMC's, the Attorney General's and the Los Angeles Superior Court's interpretation of Section 33207.5(e.) The private attorney hired by the auditor says the language of Section 33207.5(e) has been interpreted too broadly— that the Legislature either did not know, or could not have meant that there is a difference between the terms "division" and "section" in Section 33207.5(e). The division to which Section 33207.5(e) applies, of course, is Division 23 of the Public Resources Code entitled the "Santa Monica Mountains Conservancy Act."

In another section of Division 23 the Legislature enacted similar language but specifically chose in that instance to limit the power of the executive director to "such actions as are necessary to carry out the provisions of this *section*." Public Resources Code Sec. 33205.5(f). [Emphasis added.]

The Los Angeles Superior Court has ruled on the very question of the breadth of Section 33207.5(e). The question in that case was whether subdivision (e) permitted SMMC the power of eminent domain without approval of the Public Works Board. The Court analyzed the entirety of Division 23 and found that a broad interpretation of subdivision (e) was "the only common sense construction that the Court can make of the entirety of the legislation."

Judge Cooperman's opinion in the case of *Mountains Recreation and Conservation Authority* v. *Soka University of America,* No. BC-071672, November 23, 1994, is instructive, and will be quoted from at length (Tr. pp. 43-44):

> The Court notes that [Sec.] 33203, together with the intent of the legislature, as set out in the historical note, indicates that it is the intent of the legislature in enacting [Sec.] 33203 to facilitate the acquisition of critically needed park properties, and refers to the following language also the historical note:
>
>> In the event of any conflict between Subdivision (e) of Section 33207.5 of the Public Resources Code, and Section 33203 of the Public Resources Code and any other provision of law with respect to the authority of the Executive Director of the Santa Monica Mountains Conservancy to acquire real property on behalf of the Conservancy, the provisions of Subdivision (e) of Section 33207.5 shall govern.

And that section says:

> Further, notwithstanding the provisions of the Property Acquisition Law, that is commencing with Section 15850, and any other provision of law, the Executive Director of the Conservancy may take such actions as necessary to carry out the provisions of this division.

Not section—division, as counsel for the plaintiffs have pointed out to the Court.

> And together with that Section 33203.5 of the Public Resources Code, notwithstanding any other provision of this division, the Conservancy may acquire and improve real property or any interest therein anywhere within the zone upon a finding that the action is consistent with the plan.

Sec. 33207.5(e) provides the Conservancy with the flexibility to meet the mandate of the Legislature which found and declared "that the Santa Monica Mountains Zone . . . is a unique and valuable economic, environmental, agricultural, scientific, educational, and recreational resource which should be held in trust for present and future generations . . . ." (Public Resources Code Sec. 33001.)

The audit also suggests that the Legislature did not have the power to delegate the power to acquire land on terms to the Conservancy when it enacted Sec. 33207.5(e). However, Government Code Sec. 15854.1 (contained in the Property Acquisition Law) states: 8

> At the request of the owner of property acquired pursuant to this part, *the board may enter into an agreement with the owner specifying the manner of payment of compensation* to which the owner is entitled as a result of the acquisition. The agreement may provide that the compensation shall be paid by the board to the owner over a period not to exceed 10 years from the date the owner's right to compensation accrues. The agreement may also provide for the payment of interest by the board; however, the rate of interest agreed upon may not exceed the maximum rate authorized by Section 16731 or 53531 of the Government Code, as applicable, in connection with the issuance of bonds. [Emphasis added.]

The State Public Works Board has the power to purchase property on such terms as provided for in Section 15854.1. Any acquisition made by the Conservancy by and through the Public Works Board may be made pursuant to Section 15854.1. There is no inconsistency therefore with the Legislature also providing the Conservancy with the authority to exercise a like power and manner of acquisition. Please note that the Legislature did not place a cap on the amount of compensation to be paid to the seller when Section 15854.1 was enacted in 1982.

The Office of the Attorney General is the legal advisor to the SMMC and unless changed by legislation or court ruling, such advice is conclusive upon the agency

The Attorney General has advised the SMMC that Sec. 33207.5(e) gives the Conservancy the power to purchase real property on terms. It further states that the acquisition of real property on terms may be considered a manner by which the Conservancy may exercise its power to acquire.

The audit disagrees with the Attorney General's office and takes SMMC to task for adhering to such advice. We believe that Government Code Sec. 11157 allows us no choice but to follow the advice of the Attorney General. In relevant part it provides 9

> The Attorney General is the legal advisor of each department in all matters relating to the department and to the powers and duties of its officers.

In addition to the advice received from the Office of the Attorney General, the Conservancy and the Mountains Authority also relied on the advice of its staff counsel on the issue of acquisition of real property on terms when the acquisition was made.

SMMC PROPERLY GRANTED FUNDS TO MOUNTAINS AUTHORITY FOR WILDLIFE PROTECTION ACT PURPOSES WITHOUT LEGISLATIVE ACTION BECAUSE THE HABITAT FUND IS CONTINUOUSLY APPROPRIATED BY INITIATIVE STATUTE 10

The audit says the SMMC should have deposited the proceeds from the sale of Paramount Ranch to the National Park Service into the Santa Monica Mountains Conservancy Fund, and awaited a reappropriation by the Legislature before granting them to the Mountains

Authority for other habitat acquisitions. This is a curious assertion in light of the fact that the audit faults SMMC for doing precisely what, in another section of the report, it recommends that the Legislature require as an amendment to the Wildlife Protection Act.

Proceeds from the sale of HCF acquired property should be used for HCF purposes, which is exactly what the SMMC did when it granted proceeds to Mountains Authority for other habitat acquisitions 10

The whole question here is when property purchased with HCF funds is sold, do the proceeds get deposited in a fund where they can be appropriated to a *different,* non-Habitat Conservation Fund purpose, or should they be dealt with in a way that ensures they are used for HCF purposes, consistent with the continuous appropriation contained in the initiative statute itself?

The question contains its own answer—Habitat Conservation Fund dollars should be used for HCF purposes. To put HCF monies where they are subject to annual appropriation, potentially for non-HCF purposes, is in direct violation of both explicit language of Section 2787 and the general intent of the measure. The Attorney General is specific about this (see memorandum opinion of Deputy Attorney General Terry T. Fujimoto, Attachment "A-3"). The audit itself says: *

> [T]o ensure that proceeds from the sale of land or property rights purchased with the fund are used to further the intent of the act, the Legislature should consider an amendment to the act requiring state agencies to re-deposit these moneys into the fund.

That is a good idea. It is, in fact, exactly what SMMC did by re-granting proceeds to the Mountains Authority for other habitat acquisitions. If the SMMC had deposited the proceeds in the Conservancy Fund as suggested by the audit it would have been "a clear violation of the Wildlife Act" (Attorney General memorandum, p. 4, Attachment "A-3"). *

*We have not included this attachment in the report; however, it is available for review at the Bureau of State Audits.

HCF's continuous appropriation obviates the need for a Legislative reappropriation of proceeds from land sales (11)

The audit says: "Granting the proceeds without legislative authorization circumvented the State's budget and appropriation process." This is a bold assertion, also a bald one that flies in the face of the explicit language of the Wildlife Protection Act itself.

Section 2787 of the Fish and Game Code provides:

> Notwithstanding Section 13340 of the Government Code, the money in the [Habitat Conservation Fund] *is continuously appropriated, without regard to fiscal years*, as follows: . . . (c) To the Santa Monica Mountains Conservancy. . . . [Italics added.]

The continuously appropriated nature of the HCF makes it *not subject* to the budget and appropriation process by definition. The SMMC had every right to grant the funds to the Mountains Authority for other habitat acquisitions, which is exactly what it did. (The Attorney General memorandum, Attachment "A-3", supports this interpretation in all particulars.) *

This position is further bolstered by Government Code Sec. 16304, which provides in relevant part:

> An appropriation containing the term "without regard to fiscal years" shall be available for encumbrance from year to year until expended. [¶] An appropriation shall be deemed to be encumbered at the time and to the extent that a valid obligation against the appropriation is created.

The relevant question then is not 'where were the proceeds deposited' but rather was a valid encumbrance made to the appropriation by SMMC's grant of the proceeds to Mountains Authority for habitat acquisitions. Staff counsel and the Attorney General have determined that the encumbrance was valid, and the audit does not question its validity.

The audit's cited references do not support its position

In support of its position the audit cites the Government Code definition of "state funds" which is totally irrelevant to the question of continuous appropriation. (12)

*We have not included this attachment in the report; however, it is available for review at the Bureau of State Audits.

The more appropriate citation is to Section 33205 of the Public Resources Code. That section requires the deposit of proceeds of land sales in the Santa Monica Mountains Conservancy Fund, and it was enacted well *before* the Wildlife Protection Act. In 1990, when Prop. 117 was passed by the voters, Section 33205 provided that the Santa Monica Mountains Conservancy Fund was *also* continuously appropriated (see Stats. 1983, ch. 1280 § 4). Therefore there was no conflict between the continuous appropriation in the Wildlife Protection Act and the provisions of Pub. Res. Code Sec. 33205 when Fish and Game Code Sec. 2787 was enacted. Both provided for continuous appropriation. 12

Only *well after* the passage of Prop. 117 was the Santa Monica Mountains Conservancy Fund made subject to annual appropriation (Stats. 1992, ch. 1304, § 5) thus giving rise to the conflict between it and the continuous appropriation of the HCF. Since Prop. 117 itself provides that Fish and Game Code Sec. 2787 may only be amended by a 4/5 vote (Prop. 117, Sec. 8), clearly it cannot be said to have been amended by implication because of a change to the Public Resources Code. Therefore, to the extent that there is a conflict between Public Resources Code Sec. 33205 and the Wildlife Protection Act, the initiative governs.

The SMMC grant of Paramount Ranch sale proceeds was proper and the expenditures were documented but more paperwork could have been required of the grantee 13

The SMMC board made, and the Mountains Authority board accepted, a grant of the proceeds from the sale of Paramount Ranch to the U.S. National Park Service to be used by the Mountains Authority for habitat acquisitions in accordance with the purposes of the Wildlife Protection Act. This much is undisputed. What the audit faults is a failure to better document the grant agreement, in other words: more paperwork.

We question the need for more paperwork as between the SMMC and its joint powers partner the Mountains Authority. The Joint Exercise of Powers Act (Government Code Sec. 6500 *et seq.)* contemplates an intimate relationship between parties to a joint powers agreement. The relevant portion of Section 6506 states: "One or more of the parties may agree to provide all or a portion of the services to the other parties in the manner provided in the agreement." The Mountains Authority joint powers agreement provides that SMMC executive director shall administer the agreement. In light of this day-to-day supervision it seems redundant to double-paper every transaction between the joint powers authority and the SMMC.

The audit says: "our review of the Mountains Authority accounting records found that it did not separately account for the expenditures related to this grant." This is not true. The State Auditor's staff were provided with copies of the escrow closing documents for the properties purchased (Canyon Oaks property in Topanga and the Lecohabe property in Studio City). They were also provided with a copy of the apportionment between HCF and Los Angeles County Prop. A funds between those two acquisitions. It is not a question of the money disappearing somewhere. 14

While the funds were "accounted for" in the popular meaning of the term, it is true that *separate* accounts were not created. The Mountains Authority joint powers agreement provides that the fiscal officer is the general manager of the Conejo Recreation and Park District, therefore the Mountains Authority contracts with the Conejo RPD to provide accounting services. At the time of these transactions such separate accounts were not maintained. Subsequently both the Conejo district's accounting system has been changed to provide for such sub-accounts and the SMMC has obtained the capacity for "real time" access into the system. These changes will improve the documentation so that funds from one source (e.g., HCF) can be automatically accounted even through multiple transactions.

ADVANCE PAYMENT ON GRANTS WAS PROPER BUT BETTER PAPERWORK COULD HAVE BEEN DONE 15

The auditor doesn't like advance payments, but there is nothing in law to prohibit them, and in small agencies like the Mountains Authority advance payments are necessary in order to maintain cash flow. The audit responds to this by saying,

> The Mountains Authority spent the $166,000 advance over the following fiscal year primarily for routine payroll expenses; therefore, it did not have an immediate need for the entire advance.

The argument does not follow. The payroll expenses were to implement the grant, without that cash-flow that part of the payroll attributable to the restoration grant could not have been met.

But the grant could have been more carefully written to specify exactly what services were to have been performed when the payment was to be made "upon invoice."Although advance payments to Mountains Authority were common and necessary (see above), it is true that the contract for the one restoration grant mentioned by the audit should have

been modified to provide for advance payments when it was clear that such payments would be necessary. The failure to do so is a legitimate criticism.

Restoration grant documentation was proper and resulted in a conservative billing to the HCF 16

We disagree with the audit's conclusion that the restoration grant payroll "splits" were inadequately documented. Percentage payroll "splits" are a common means of allocation where repetitive and predictable work is performed by field personnel. Because such personnel cannot document their time as well as lawyers sitting at computer consoles, workers and management develop the "standard splits" that are used in payroll allocation. Regular management meetings reviewed the work output. The use of predetermined percentages in this instance was entirely supported by work output on park restoration projects. The allocation of .33 of field/ranger staff time to these projects was in most instances a *conservative* estimate of the number of hours actually spent on restoration projects.

To the extent that the auditor's staff wanted periodic memoranda in the file re-attesting to the validity of the payroll splits, it is yet another example of: More paperwork.

$34,000 in subgrants could have been better documented, but changes have been made to eliminate this problem

With respect to the nonprofit organization subgrant in the amount of $34,000, we agree with the audit, but only up to a point. There were accounting problems with the nonprofit organization, and with Mountains Authority's monitoring thereof. However, it is not an issue of improper expenditure—the invoices were provided to the auditors for purposes consistent with the grant. The problem was that the invoices were not properly recorded against the particular grant. Both accounting and personnel changes have been made to ensure that this problem does not occur in the future. Moreover, the Mountains Authority no longer uses nonprofit organizations as subgrantees for this kind of work.

ANALYSIS OF AUDIT RECOMMENDATIONS

We disagree with the following recommendations:

- *Require grantee to demonstrate financial ability to complete the project.* This implies that a change needs to be made. In fact no default has ever occurred, and the SMMC in the exercise of its vested discretion reserves the right to award an acquisition grant and then further augment it from future SMMC funding sources. The record of SMMC/Mountains Authority accomplishments speaks for itself on that issue.

- *Deposit proceeds from sale of state lands into the state treasury.* Deposits will be made, as they have been, according to the applicable law as interpreted by counsel and the Attorney General who is the exclusive legal advisor to SMMC with respect to its powers and duties.

- *Clarify the use of promissory notes by modifying the Santa Monica Mountains Conservancy Act.* The law is clear to counsel, the Attorney General, and the Superior Court. The act should not be tinkered with at the behest of a private attorney hired by the auditor.

Comments

California State Auditor's Comments on the Response From the Santa Monica Mountains Conservancy

To provide clarity and perspective, we are commenting on the Santa Monica Mountains Conservancy's (Santa Monica Conservancy) response to our audit report. The numbers correspond to the numbers we have placed in the response.

1 As a point of clarification, the Attorney General letters providing advice to the Santa Monica Conservancy are not formal Attorney General Legal Opinions as inferred.

2 Evidently, the Santa Monica Conservancy is suggesting that the ends justify the means. Although we did not assess, nor do we question, the important conservation value of the land it acquired, we do question the manner in which the Santa Monica Conservancy acquired the land and the associated costs. The Santa Monica Conservancy fails to consider that the moneys it uses are entrusted to it for specific purposes and the conditions for their use are established in law.

Specifically, while we do not debate that leveraging funds allowed the Santa Monica Conservancy to protect more land, we do question the Santa Monica Conservancy's legal authority, and thus, the legal authority of the Mountains Recreation and Conservation Authority (Mountains Authority), to use notes to acquire land. While this legal question may be subject to debate, our attorney does not believe that the Santa Monica Conservancy and the Mountains Authority have this legal power. Therefore, we recommend that the Legislature clarify its intent related to the Santa Monica Conservancy's use of promissory notes.

Furthermore, contrary to the Santa Monica Conservancy's statements, the payment of interest on promissory notes increases the cost of acquiring land and using notes to acquire land puts state assets at risk of potential loss. For example, as we discuss on page 13, because the Santa Monica Conservancy used notes to acquire lands, approximately $2.2 million in additional money was used for interest and late payment fees. Additionally, because the Mountains Authority used a note to acquire the Paramount Ranch and could not pay the note as

planned, it had to restructure and extend the due date of the note twice and, eventually, the Santa Monica Conservancy had to purchase the land from the Mountains Authority when the note was coming due a third time. Although the Santa Monica Conservancy did prevent the loss of this land, the potential risk of loss existed.

Moreover, when the Santa Monica Conservancy chose to purchase the Paramount Ranch, it put the Mountains Authority's interests ahead of the State's. As we discussed on page 12, the Santa Monica Conservancy chose [illegible] acquire the Paramount Ranch at its appraised value [illegible] rather than grant the Mountains Authority th[illegible]1 million it needed to pay the note balanc[illegible] interest. Thus, it paid approximately $2 mil[illegible] than necessary to acquire this land.

(3) Although we do not dispute that the 1989 appraised value of the Paramount Ranch was $21 million, this value is irrelevant to the transactions we reviewed. When the land was acquired by the Mountains Authority two years later in 1991, the appraised value had decreased to $15.5 million. Furthermore, when the land was purchased by the Santa Monica Conservancy from the Mountains Authority two years later in 1993, the appraised value of the land had decreased to $13 million.

(4) We question the Santa Monica Conservancy's, and thus the Mountains Authority's, legal authority to use notes to finance land acquisitions. According to our legal counsel, the powers of the Mountains Authority are limited to the common powers of the parties to the agreement creating this joint powers entity. Therefore, as we explain in the report, if the Santa Monica Conservancy does not have the expressed legal authority to use promissory notes, the Mountains Authority also does not have this power. Additionally, even though the agreement creating the Mountains Authority tries to expand its powers to those of the park districts, it cannot because the power is not common to all the parties. This later point is supported by several formal Attorney General Opinions which we previously provided to the Santa Monica Conservancy's staff counsel.

The Santa Monica Conservancy has relied on advice of staff counsel that it does have the power to use notes and, more recently when we questioned this power, has sought affirmation of this advice from the Attorney General's Office. The Attorney General argues that the Santa Monica Mountains Conservancy Act does provide the Santa Monica Conservancy with broad powers including the use of notes. The Attorney General bases

its argument on a broad reading of a section of the Santa Monica Mountains Conservancy Act and the Los Angeles Superior Court's interpretation of this section. However, our legal counsel does not agree with this broad reading of the section. Further, according to our legal counsel, the Los Angeles Superior Court ruling is only applicable to the specific situation and does not set legal precedent. Therefore, we and the Santa Monica Conservancy have a difference of opinion regarding its ability to use notes and recommend that the Legislature clarify the expressed powers of the Santa Monica Conservancy.

5 We do not agree that notes are better than options. In the acquisition of the Paramount Ranch, using the Santa Monica Conservancy's estimated annual 10 percent option price, a two-year option to purchase the property for $15.5 million would have cost approximately $3.1 million. By using a note to purchase the Paramount Ranch, the Santa Monica Conservancy invested a total of $5.5 million to purchase the land. Under both methods there are risks of losing funds. As we state in the report, when the Mountains Authority could not pay the note as planned, the Santa Monica Conservancy purchased the land from the Mountains Authority so that they would not lose their investment.

6 The Santa Monica Conservancy's logic is flawed. Specifically, when land is purchased outright, there is no risk of loss. However, when land is purchased using a note, both the money invested and the land are at risk of potential loss if the note cannot be paid.

7 On the advice of our legal counsel, release of this opinion would violate our attorney-client privilege.

8 We do not debate the Legislature's authority to delegate power to the Santa Monica Conservancy. However, we do question the Santa Monica Conservancy's broad application of a specific delegation for the acquisition of a school district property to its other acquisitions. For this reason, we recommend that the Legislature clarify the Santa Monica Conservancy's legal authority to use notes.

9 We do not question the Santa Monica Conservancy's reliance on the Attorney General's advice. We question the prudence of using notes and the legal authority to use notes. Furthermore, the Santa Monica Conservancy relied on staff counsel and did not seek written advice from the Attorney General until October 1996, when we questioned the Santa Monica Conservancy's authority to use notes to acquire land.

(10) According to the Department of Finance, because the act creating the Habitat Conservation Fund is silent as to disposition of proceeds from the sale of land purchased with the fund, the Santa Monica Conservancy should have deposited the money into the state treasury and the Santa Monica Mountains Conservancy Fund, as required by existing state law. By not depositing the sale proceeds into the Santa Monica Mountains Conservancy Fund, the Santa Monica Conservancy violated Public Resources Code Section 33205. Further, while we believe that proceeds from the sale of land acquired with the Habitat Conservation Fund should be re-deposited in the fund, this requirement is not specifically mandated in the act. Therefore, the Santa Monica Conservancy should adhere to its other legal provisions that require the deposit of proceeds from the sale of Santa Monica Conservancy land into the Santa Monica Mountains Conservancy Fund.

(11) According to the Department of Finance, although the act provided for continuously appropriated Habitat Conservation Fund moneys to the Santa Monica Conservancy, the Santa Monica Conservancy received its Habitat Conservation Fund appropriations through the Budget Act. Consequently, the continuously appropriated nature of the funds is limited to those appropriated in the Budget Act. Therefore, according to the Department of Finance, had the Santa Monica Conservancy deposited the money from the sale of land into the Habitat Conservation Fund, the moneys would be subject to appropriation by the Legislature.

(12) The code sections cited in our report (Government Code, Sections 16305.2 and 16305.3) are correct. These sections require the Santa Monica Conservancy, a state agency, to deposit state money (proceeds from the sale of state property) into the state treasury. We also cite Public Resources Code, Section 33205.

(13) We disagree with the Santa Monica Conservancy's characterization that requiring a written grant agreement is simply more paperwork. We believe that a written agreement that spells out the terms and conditions of the grant is essential to protect the State's interests.

(14) As the Santa Monica Conservancy concedes in its response, at the time of this transaction, the Mountains Authority did not properly account for the proceeds and related expenditures. While the Santa Monica Conservancy states that the grant moneys were spent on certain projects, we could not link the proceeds with the expenditures because of the Santa Monica Conservancy's lack of a grant agreement and the Mountains Authority's poor accounting.

15 The Santa Monica Conservancy's statement is not true. We have no objections to advances as long as the terms and conditions of the grant agreement provide for advances and the amount of the advance is necessary for the short-term needs of the project. However in this case, the agreement did not provide for advances and the Mountains Authority did not have an immediate need for the advance to complete the restoration work.

16 We agree that using percentages to allocate payroll costs is acceptable. However, the Mountains Authority could not support the basis for the percentages used and, as a result, we could not determine if the payroll costs were properly charged to the grant. Furthermore, during the later stages of the restoration work, Mountains Authority employees charged actual hours worked to the restoration grant project, and the Mountains Authority appropriately allocated the payroll costs based on these actual hours. We did not question these payroll charges to the restoration grant.

Coastal Conservancy

April 15, 1997

Kurt R. Sjoberg
California State Auditor
Bureau of State Audits
660 J Street, Suite 300
Sacramento, California 95814

Re: Your "Habitat Conservation Fund" draft audit report

Dear Mr. Sjoberg:

This letter sets forth the State Coastal Conservancy's comments in response to your draft audit report, provided to us on April 10, 1997. The draft report is critical of the Coastal Conservancy's Sinkyone project in Mendocino County, a complex undertaking in which we have been involved for more than ten years and which is not yet fully complete. In 1995, the Conservancy authorized the expenditure of Habitat Conservation Funds as a grant to a nonprofit organization to acquire a conservation easement over the property.

The draft audit report acknowledges that this is an appropriate use of Habitat Conservation funds. However, it completely mischaracterizes the Sinkyone project, leaving the impression that somehow the Conservancy paid for what it could have gotten for nothing. We cannot disagree more. The decision to subject the Sinkyone property to a conservation easement cost the state a precise amount of money, was made with full public notice, with all due deliberation, and resulted in the best allocation of available financial resources to accomplish multiple purposes of the Sinkyone project. 1* 1

Because of the complexity of the project and the draft audit report's misunderstanding of its context, components, and legal basis, it is necessary to respond extensively. This letter provides an overview, in clear terms, of our general response to the draft report's criticism; in Parts I and II of the Appendix, we describe the project and provide more detailed analysis of the authority for the Conservancy's loan; and in Part III we provide specific responses to statements made in the draft audit.

1330 Broadway, 11th Floor
Oakland, California 94612-2530

*The California State Auditor's comments on this response begin on page 81.

The draft audit report misstates the facts, ignores relevant provisions of law, and completely mischaracterizes the Coastal Conservancy's Sinkyone project. It is telling that the report does not dispute that the grant of funds to a nonprofit organization for the acquisition of a conservation easement was an appropriate use of Habitat Conservation Funds. In this respect alone is the draft report correct. 1

The Conservancy did not pay for something which it could have gotten for nothing. It did not pay twice for the same property, as is implied. It did not waste state dollars in any way; in fact, it leveraged available funds to obtain *increased protections for resources and full reimbursement to the State.* State funds are not being unlawfully held outside the state treasury, nor are habitat conservation funds being used for management of property in contravention of law.

The Coastal Conservancy entered into a contract in 1987 (three years before the Habitat Conservation Fund was established) with the Trust for Public Land in which a $1.1 million loan was made to TPL, secured by 4000 acres of redwood land. The Conservancy wisely negotiated the terms of repayment to provide that, upon sale of the property and reimbursement of the Trust's costs, all gains on the value of the property accrued to the State. If the land were sold at fair market value without restriction today, the State's loan of $1.1 million would bring in over $3.1 million. Indeed, it was originally 2
intended that the property be sold for sustainable timber production, which *would have* realized such a gain.

Instead, the Coastal Conservancy chose to place a strict conservation easement on the property which reduced its value back to $1.1 million. It did this to prevent intensive logging of the land, protect habitat values, and preserve the integrity of the adjacent State Park. Implementing this decision cost the state $2 million (the fair market value of the easement, as established by appraisal). This is the cost of habitat protection on the property, whether purchased or simply given away. The Conservancy specifically determined that the cost of habitat preservation should be borne by the Habitat Conservation Fund, rather than the State Coastal Conservancy Fund, which would have otherwise lost the $2 million in revenue.

Our decision to attribute the cost of the easement to the Habitat Conservation Fund was good public policy. When the bulk of these funds are returned to the Conservancy Fund, pursuant to terms of a valid contract, they will be available to the Legislature for appropriation for any of the Conservancy's programs. We will have achieved the protection of 4000 acres of habitat in a manner completely consistent with the purposes of the Habitat Conservation Fund. We will have made over $1.7 million available for Conservancy programs (including coastal resource acquisition, enhancement and restoration, agricultural preservation, public access, and, yes, habitat conservation) from the Coastal Conservancy Fund, giving the Legislature, the Governor, and the Conservancy increased flexibility to achieve coastal protection purposes.

When the final sale of the property is made later this year to the InterTribal Sinkyone Wilderness Council, we will realize another gain of $1.4 million, more than the original loan and more than current fair market value of the property as restricted by the conservation easement. Nearly all our costs for this project will have been reimbursed so that the State's total outlay for the project approaches zero. At this nominal cost we will have protected 4000 acres of habitat, ensured public access to the coast, and helped to create the nation's first InterTribal Park. This is flexible, innovative, "re-invented" government at its best. Praise, not criticism, is justified for such great benefits at so little cost.

The draft audit report's characterization of the outstanding reimbursement is false. 3
Your staff, in their objection to "paying" certain costs from the Habitat Conservation Fund, confuse the expenditure of Habitat Conservation Funds with uses made of the proceeds of a sale of property. It also mischaracterizes a debt, not yet payable under terms of an existing contract, as "state money". These proceeds of sale are not state 4
funds. They are funds of the Trust for Public Land, a portion of which, under contract, are owed to the Coastal Conservancy. When paid in accordance with requirements of the contract, they will *then* be immediately deposited in the state treasury as is required by law.

In summary, the Conservancy deliberately and publicly chose to make the transfer of the conservation easement through a grant ***which will be reimbursed*** under terms of the existing contract, rather than by requiring its transfer to be without consideration. We did this with full disclosure to our board in two public hearings. We did this in light of the Auditor General staff's expressed concern prior to the close of the transaction. We would do it again in the same way, notwithstanding the Auditor's report. The Auditor's draft report is, simply, wrong. 1

Sincerely,

Michael L. Fischer
Executive Officer

APPENDIX

STATE COASTAL CONSERVANCY
RESPONSE TO DRAFT AUDIT REPORT
ON USE OF HABITAT CONSERVATION FUNDS

I. The Sinkyone Project

In 1986, the Conservancy made a grant of $1.1 million in park bond funds to the Trust for Public Land (TPL) to aid in the acquisition of 7,100 acres of timberland from the Georgia-Pacific Corporation. TPL acquired the land and then conveyed portions of it to the Department of Parks and Recreation, resulting in the addition of 3000 acres to the Sinkyone Wilderness State Park. Disposition of the remainder 4000-acre upland parcel was governed by the Conservancy's grant agreement with TPL: TPL was to market and sell the property for logging, after developing a disposition plan to allow public access to the coast and provide timber harvest rules to protect the land's most sensitive resources. The proceeds of sale were to be returned to the Conservancy in reimbursement for its $1.1 million loan, and to compensate TPL for its project costs (including the loss of tax revenue to Mendocino County). In its original conception, the Sinkyone project enabled the acquisition and provision of public access through the Sinkyone Wilderness State Park; the remainder parcel was a financial resource to reimburse the Conservancy and TPL for their respective project costs, and to accomplish multiple goals for the area.

From 1986 through the early 1990's Conservancy staff worked with TPL and other interested parties to develop rules for responsible timber harvest; to identify prospective buyers; and to otherwise ensure proper management of the property prior to sale. During this period, there were unexpected developments: (1) the price of redwood double or tripled, the trees grew, and the value of the 4000-acre parcel increased to over $3 million; and (2) the InterTribal Sinkyone Wilderness Council(ITSWC), a nonprofit corporation organized by a consortium of Indian tribes, was formed and began to work vigorously to acquire the property for an InterTribal Park. ITSWC envisioned the InterTribal Park as a center for Indian gatherings and preservation of traditional practices and uses, and wanted a much more restrictive and protective easement over the entire property than the Conservancy and TPL had planned.

Thus, in March 1995, the Coastal Conservancy approved TPL's option or sale of the property to ITSWC for a total purchase price of $1.4 million - a $300,000 increase over the amount of the Conservancy's original grant - subject to a conservation easement in favor of the Pacific Forest Trust (a nonprofit corporation) and to an offer-to-dedicate public access easements in favor of the Conservancy. The proceeds of sale (net after retention of the first $100,000 by TPL pursuant to the existing grant agreement) were to

be remitted to the Conservancy. TPL would continue to hold and manage the property during the two- to three-year option period.

At the same time, the Conservancy authorized a grant of $2 million in Habitat Conservation Funds to the Pacific Forest Trust (PFT) for acquisition of the conservation easement. Since the purpose of the conservation easement is to protect riparian habitat, and that of other protected species, the Habitat Conservation Fund is an appropriate source of funds for this grant.

The draft audit report claims that since the Conservancy controlled disposition of 2
the property and the proceeds of sale of any interest in the property, pursuant to its grant agreement with TPL, it could have simply directed TPL to convey the conservation easement to PFT <u>at no cost</u>. We disagree: the cost of such action to the State of California would be $2 million. The draft audit report's characterization of "no cost" is not just wrong; it is, in fact, untruthful. It thinks only in terms of dollars, not in terms of real value. Had the Conservancy acted in the manner recommended by the draft report, 5
the increment of value resulting from timber growth and market changes over the last ten years would simply have been lost to the State. (The State Treasury would only have been reimbursed for the value of the property subject to the conservation easement.)

Instead, the Conservancy made a grant of funds to the Pacific Forest Trustfor acquisition of the conservation easement, recognizing that the proceeds of TPL's sale to PFT would be repaid to the Conservancy *under terms and conditions of the existing TPL contract.* The effect of this arrangement was that the Habitat Conservation Fund paid the 1
cost of preserving the property's riparian and species habitats (by means of the conservation easement), and the State Coastal Conservancy Fund was both reimbursed for the original outlay and realized the increased value of the property.

The draft audit report's complaint amounts to an objection that the Conservancy could have funded the conservation easement from other sources available to it. This is true. The cost of the conservation easement could have been funded from the Coastal Conservancy Fund, which has less money to use for more broad general purposes. The Coastal Conservancy chose not to do that, in the lawful exercise of its discretion. The state benefited from this choice: this was a "win-win" situation, one of our hallmarks. 6
There was no loss here to be criticized.

II. <u>Reimbursement of Conservancy Loan</u>

The draft audit report claims that state funds are unlawfully being held on behalf of the Conservancy in a nonprofit organization's name. This is a gross mischaracterization of a transaction which is fully authorized by relevant provisions of law, one to which you 4
should not put your name.

In the first instance, the proceeds of sale of any property interest are paid to and belong to the seller of property. The Trust for Public Land is the owner and seller of the Sinkyone property. It has a contractual obligation to repay the Conservancy for a 1986 non-HCF loan in the amount of $1.1 million; the terms of repayment provide for sharing of the proceeds of sale between the Trust and the Conservancy. The loan was authorized pursuant to Public Resources Code Section 31118 which provides that the Conservancy "may seek repayments of funds granted pursuant to this division [Division 21 of the Public Resources Code] on such terms and conditions as it deems necessary to carry out the provisions of this division." 4

Under provisions of the contract and Conservancy-approved terms of sale, the Conservancy will be more than fully reimbursed for its 1986 grant and will also realize the additional increment of property value through the sale of the property in two transactions: conservation easement and fee interest. The seller will also be reimbursed a portion of its costs, and has provided compensation to Mendocino County and a management endowment for the easement holder. 3

Since the Conservancy has legal authority to seek repayments of its grants on terms and conditions it deems appropriate to carrying out its purposes, provisions of the TPL grant requiring deposit of the proceeds from sale of the conservation easement in an interest-bearing account and repayment to the Conservancy at a later specified date was also appropriate. The Conservancy could have required that the repayment be made immediately upon sale of the property interests, in which case the funds would have been deposited in the State Coastal Conservancy Fund in the State Treasury at close of escrow. 4

However, the Conservancy also has the authority under law, in the exercise of its discretion, to require payment of these funds at a later date, at an agreed-upon rate of interest, or subject to such other terms and conditions as the Conservancy deems appropriate. We have exercised that authority, without criticism, for twenty years. The Conservancy also has discretion to require only partial reimbursement, or not to require reimbursement at all. In this case, the Conservancy authorized use of a limited amount of the proceeds to pay project costs, and directed its grantee to invest the funds for repayment to the Conservancy no later than two years from the date of close of escrow, or earlier if the Conservancy so required.

Upon repayment pursuant to the grant agreement, such funds are or will be deposited in the State Coastal Conservancy Fund in the State Treasury in accordance with Public Resources Code Section 31011. The law requires the deposit in the state treasury of "money in the possession of or collected by any state agency" (Govt. Code Section 16305.3 and 16305.3). Until such time as the grantee's repayment obligation becomes due and payable, money has not come into possession or been collected by the state agency, and there is no legal requirement that it be deposited in the State Treasury. 4

III. Specific Response to Audit Statements

S-2 *"The Coastal Conservancy granted $2 million to a nonprofit organization to acquire an easement the Coastal Conservancy was entitled to receive from a second nonprofit organization (seller) at no cost."*

RESPONSE: Contrary to this statement, the conservation easement had a precise cost, as measured by an appraisal of the property's fair market value. That cost is $2 million; i.e., had the Conservancy simply directed its grantee to convey the easement without consideration, the State would have lost $2 million. The State Coastal Conservancy Fund could have realized the full market value of the property, had it been sold without the protective easement. Instead, the Conservancy chose to protect the property's natural resources through the mechanism of a conservation easement, and, appropriately, it chose to allocate the costs of preservation to the Habitat Conservation Fund. 2

S-2 *"The Coastal Conservancy ... allowed the seller to use $300,000 of the proceeds to pay land management and other costs inconsistent with the purpose of the [Habitat Conservation]fund."*

RESPONSE: The seller was entitled under the existing contract to retain the costs of its land management, and to pay certain other costs, *from the proceeds of sale* of the property, prior to reimbursement of the balance to the Conservancy. This was a feature of the Conservancy's 1986 (non-HCF) grant, which would have obtained even if the property was sold without restriction, or if (as the audit recommends) the conservation easement had been conveyed "at no cost". The Conservancy is authorized under Public Resources Code Section 31118 to require repayments of funds granted on such terms and conditions as it deems appropriate to carrying out Division 21 purposes. The Conservancy lawfully determined, in the exercise of its discretion, that a nonprofit organization which held 4000 acres of property for over ten years subject to extensive requirements and limitations on its use and disposition should be reimbursed for its costs in doing so. In fact, the proceeds from the sale of the fee interest alone will exceed the state's costs of acquisition by $300,000. Therefore, there was no use of Habitat Conservation Funds for this legitimate project purpose. 3

The expenditure of Habitat Conservation Funds was for the other legitimate purpose of acquiring a conservation easement over the property, and was limited to $2 million or fair market value of the easement, whichever was less. No funds in excess of that amount were expended for payment of land management or other costs. The Conservancy agreed to permit the Trust for Public Land to make $150,000 of the proceeds available to the conservation easement buyer as an endowment to carry out the purposes of the conservation easement. This was not an expenditure of Habitat Conservation Funds; Habitat Conservation Funds were expended solely for the acquisition of the conservation easement.

S-2 *"The Coastal Conservancy ... required the seller to deposit the remaining $1.7 million into a private account until such time as the Coastal Conservancy requests disbursement of the money for deposit in the State Coastal Conservancy Fund. As a result, $2 million of the fund is no longer available to acquire, restore or enhance additional wildlife habitats, and at least $1.7 million of state money is not adequately safeguarded, as state law requires."*

RESPONSE: The Conservancy specifically required the seller to reimburse to it the remaining $1.7 million, with interest, two years after the date of recordation of the conservation easement, unless earlier reimbursement was requested by the Conservancy. The requirement to deposit the balance of sale proceeds and repay the Conservancy was entirely consistent with Public Resources Code Section 31118; until payment of these monies was required and made, they were not "state money" and therefore not subject to laws requiring their deposit in the state treasury. They were proceeds of the sale of real property, duly paid to and held in the possession of the seller of that property. 4

The law requires the deposit in the state treasury of "money in the possession of or collected by any state agency" (Govt. Code Section 16305.3 and 16305.3). The funds in question have not been collected by the Conservancy and are not in its possession. Upon payment pursuant to terms and conditions of the grant agreement, these funds will be duly deposited in the State Coastal Conservancy Fund in the State Treasury, from which they are subject to appropriation by the Legislature for Division 21 purposes, including purposes consistent with the Habitat Conservation Fund.

Thus, $2 million of the fund was appropriately used to acquire, restore and enhance wildlife habitat, in the first instance, and over $3 million, as a result of the sale, is also available to acquire, restore or enhance additional wildlife habitats (or for other Division 21 purposes, if the legislature so chooses).

S-3 *"The Coastal Conservancy should deposit into the state treasury, and credit to the Habitat Conservation Fund, the moneys held by a nonprofit organization on its behalf. In addition, it should neither directly nor indirectly use the fund for purposes inconsistent with the act."*

RESPONSE: Repayments of the Conservancy grant will be deposited into the state treasury when they are duly collected pursuant to provisions of the grant contract. Pursuant to Public Resources Code Section 31011, they are to be deposited and credited to the State Coastal Conservancy Fund, not the Habitat Conservation Fund.

Use of the Habitat Conservation Fund for the conservation easement was entirely consistent with the act. The draft audit report does not dispute this. The Conservancy has not and will not use the fund for purposes inconsistent with the act, directly, indirectly, or otherwise. There is no basis whatever for such accusation by innuendo. 3

1-1 *The Coastal Conservancy " engaged in .... transactions that resulted in the State paying more than necessary to acquire land or property rights."*

RESPONSE: This is patently false. The Conservancy paid $1.1 million for the acquisition 2
of property by a nonprofit organization, resulting in (1) the addition of 3000 acres to the Sinkyone Wilderness State Park; (2) the sale of fee title to 4000 acres of upland property to a nonprofit organization for management as an InterTribal Park, subject to a conservation easement and to dedicated public access easements connecting to the State Park and the coast; and (3) full reimbursement of the original grant. The cost of the conservation easement was paid by a grant from the Habitat Conservation Fund that will also be reimbursed to the State. The costs of management of the property for over ten years, including all transaction costs relating to its disposition, and the costs of a management endowment for the conservation easement - cumulatively totaling $300,000 - are to be paid from the proceeds of these transactions, at no additional cost to the State.

In short, the Conservancy paid out a total of $3.1 million and will be reimbursed at least $3.1 million. Acquisition of the Sinkyone Wilderness State Park would not have been possible without this grant. Additionally, the public is assured of the conservation of sensitive resources over the adjacent upland property, and public access through that property to the State Park and the coast.

1-1 *The Conservancy "did not always deposit funds into the state treasury as the law requires."*

RESPONSE: The Conservancy *always* deposits state moneys in the state treasury, as the 4
law requires. Any allegation to the contrary is false and untruthful. The draft audit wrongly interprets the law as dictating the terms and conditions of Conservancy loan repayments, when a statute expressly vests discretion to specify those terms and conditions in the Conservancy. Further, it wrongly misinterprets the law with respect to the meaning of funds "in the possession of or collected by" state agencies.

1-2 *The Coastal Conservancy "was entitled to receive the easement at no cost."* 2

RESPONSE: If the Coastal Conservancy had required transfer of the easement "at no cost", the Coastal Conservancy Fund *would have lost $2 million in revenue*. The Conservancy did not, in fact "receive" the easement. It granted funds to an independent nonprofit organization to acquire the easement from the fee owner (not the State of California), and required the easement holder to manage and maintain the easement for the benefit of the public. Had the Conservancy "received" the easement itself, the state would be liable for costs of its management and enforcement in perpetuity.

1-2 *"In a related transaction, the Coastal Conservancy allowed a nonprofit organization to use $300,000 of the $2 million to pay for land-management fees and other costs inconsistent with the purpose of the Habitat Conservation Fund."*

RESPONSE: The nonprofit organization was entitled to a portion of the proceeds of sale of the Sinkyone property (not Habitat Conservation Funds) in reimbursement of costs under provisions of an existing contract that predated the Habitat Conservation Fund grant. Absent this pre-existing contract, the nonprofit seller would have been "allowed" to use all of the proceeds from sale of interests in the property, including the conservation easement, for any purposes it chose. 3

1-2 *"[T]he Coastal Conservancy required the nonprofit organization to deposit the remaining $1.7 million into an interest-bearing account for disbursement to the Coastal Conservancy. Although this transaction occurred in June 1996, as of January 1997, the Coastal Conservancy had not collected and deposited the remaining $1.7 million of these state moneys into the treasury as the law requires."*

RESPONSE: The Coastal Conservancy required the nonprofit organization to reimburse the Coastal Conservancy the remaining $1.7 and accrued interest two years after the date the conservation easement was recorded - by September 5, 1998. The Conservancy has not collected these funds because they are not yet due and payable under terms of the agreement with the nonprofit organization. As such, they are not "state moneys" as defined under law (Government Code Section 16305.2). When collected, they must (and will) be deposited in the treasury in accordance with Government Code Section 16305.3. The draft report has simply fabricated any requirement that funds be "collected"; in fact, the only relevant provision of law (Public Resources Code Section 31118) authorizes the *Conservancy* to specify the terms and conditions under which loans are to be paid and collected. 4

1-9 to 1-10: The draft report is wrong in both its characterization of the transaction described, and in its presentation of the facts:

- The loan of $1.1 million to nonprofit B was authorized in December 1986. This authorization explicitly provided for reimbursement of nonprofit B's marketing and transaction costs from the sale of the property, and for sharing of the proceeds of sale by nonprofit B and the Conservancy. (In fact, if the sale price of the parcel was lower than the amount of the loan and marketing expenses, then payment of the Conservancy's share of the proceeds would have constituted repayment in full of the loan.) 7

2

- The Coastal Conservancy's March 1995 report does not state that upon sale of the property a conservation easement will be transferred at no cost to the Coastal

Conservancy or another designated party: to the contrary, it directs "nonprofit B" to convey the conservation easement "in consideration for an amount not to exceed $2 million, or fair market value as determined by an appraisal ..., whichever is less."

- The grant of $2 million to "nonprofit A" to purchase the conservation easement was 8
made not in June 1996, but in March 1995, in exactly the same staff report and board action that directed nonprofit B to sell the easement.

- As part of the 1995 approvals, the Conservancy did modify its loan agreement to provide for use of the proceeds to pay land and easement management costs, and compensation to Mendocino County for lost tax revenues, but these were features of the original loan agreement, modified only in light of the specific disposition plan. The only new feature of these provisions was the use of some sale proceeds to establish an easement management endowment. This had not been a feature of the original agreement for the simple reason that the original agreement did not contemplate a conservation easement.

- Sale proceeds were "still on deposit in the nonprofit's name" as of January 1997 4
because they are funds belonging to the nonprofit organization, which has a contractual obligation to repay the Conservancy at least $1.7 million by September 1998.

- The draft report acknowledges that the Coastal Conservancy can use the fund to purchase easements but states it is the Auditor's belief that the "transaction disregarded the intent of the act." All of the report's statements in support of this belief are a result of faulty, flawed logic which confuses the expenditure of Habitat Conservation Funds with the disposition of the proceeds of sale of real property. The expenditure of Habitat Conservation Funds for a conservation easement is not in question. The disposition of the proceeds of sale is a feature of a pre-existing grant agreement which does not involve Habitat Conservation Funds. (Had the property been sold prior to 1995 for logging purposes, the expenditure of Habitat Conservation
Funds in 1996 to purchase a conservation easement, with absolutely no reimbursement 2
to the State, would clearly have been unchallenged.)

- We disagree vehemently with the report's conclusion that as a result of these transactions the fund has somehow been deprived of $2 million. This is true only in the sense that the cost of any expenditure of Habitat Conservation Funds is the lost opportunity to acquire, restore, or enhance other wildlife habitats. In this case,
however, funds in excess of $2 million <u>are</u> available for those purposes, as well as for 6
other purposes of Division 21.

- Requiring "nonprofit B" to deposit $1.7 million in an interest-bearing account did not violate Government Code Sections 16305.2 and 16305.3. Government Code Section 16305.2 defines as "state money" "[a]ll money in the possession of or collected by any state agency". The proceeds of sale were collected by and remain in the possession of

the seller, "nonprofit B", until such time as "nonprofit B" is required by contract to pay them to the state. At such time as they are collected and in the possession of the Conservancy they will be deposited in the treasury as required by Government Code Section 16305.3. 4

1-11 *"As a result [of the Coastal Conservancy's Sinkyone transactions] the state agencies lost the use of approximately 4.2 million we believe they could have put to better use in protecting the State's wildlife habitats and natural areas."*

RESPONSE: This is a false conclusion, without *any* factual basis; the opposite is true. The Coastal Conservancy did not "lose the use of" its $2 million of Habitat Conservation funds; it used these funds for a valid habitat conservation purpose, which the draft report does not dispute. The draft audit report's objection amounts to a complaint that the Conservancy could have funded the conservation easement from other sources available to it. This is true. The cost of the conservation easement could have been funded from the Coastal Conservancy Fund, which has less money to use for more broad general purposes. The Coastal Conservancy chose not to do that, in the lawful exercise of its discretion. The state benefited from this choice; there is no "loss" to be complained of. Indeed, the Legislature and the Conservancy have been given new options for the use of undiminished resources. 6

1-12 *The draft report recommends that the Coastal Conservancy "promptly collect and deposit into the state treasury, and the [Habitat Conservation]fund, the state moneys that the nonprofit is holding on its behalf."*

RESPONSE: These are not state moneys that a nonprofit is holding on behalf of the Conservancy. This is a contractually obligated repayment of a loan lawfully made, which the Conservancy will collect and deposit in the treasury in due course, in accordance with the terms of its contract. There is no justification for requiring a "return" of these funds to the Habitat Conservation Fund, from which the draft report itself acknowledges they were properly expended. Pursuant to the requirements of Public Resources Code Section 31011, the funds will be deposited in the State Coastal Conservancy Fund in the state treasury when they are received. 4

Comments

California State Auditor's Comments on the Response From the State Coastal Conservancy

To provide clarity and perspective, we are commenting on the State Coastal Conservancy's (Coastal Conservancy's) response to our audit report. The following numbers correspond to the numbers we have placed in the Coastal Conservancy's response.

1 We have neither mischaracterized the Sinkyone project nor misunderstood its context, components, or legal basis. We do not question the legality of the transactions related to this project, rather we question their substance. What the Coastal Conservancy accomplished through these transactions was a transfer of $2 million from the Habitat Conservation Fund to the Coastal Conservancy Fund. In our opinion, the Coastal Conservancy used a legal means to subvert the intent of the Wildlife Protection Act of 1990 (act). We stand by our report as written.

2 Contrary to what it says in its response, the Coastal Conservancy never planned to sell the property for timber production and thus realize a $2 million gain. In fact, the Coastal Conservancy always planned to place a conservation easement on the land. Its March 1995 report states, "Since 1986, the staff has anticipated that a conservation easement/access easement would be transferred by the [nonprofit] to the Conservancy or another designated party, at the time of sale, for no cost." Since the Coastal Conservancy never planned to sell the property without an easement, it would never have realized a gain on the sale.

Thus, the Coastal Conservancy's only opportunity to realize a $2 million gain on this property was to arrange the separate sale of the easement, which it did using Habitat Conservation Fund moneys. Although using the Habitat Conservation Fund to purchase easements complies with the act, the purpose of this transaction was simply to shift moneys from the more restrictive Habitat Conservation Fund to the Coastal Conservancy Fund where, according to the March 1995 report, it ". . . may be used for any purpose of the [Coastal] Conservancy, including projects in any of our program areas such as urban waterfronts

or public access." Consequently, although we do not take issue with the legal form of this transaction, we believe it subverts the intent of the act.

3 This is also an issue of the legal form of the transaction versus its substance. The Coastal Conservancy argues that the legal transaction—the sale of the easement—transformed Habitat Conservation Fund moneys into "sales proceeds," which they believe are not subject to the restrictions imposed by the act. We disagree that using these "sales proceeds" to pay land management and other costs is appropriate. We find the Coastal Conservancy's argument to be spurious. The transaction is not an ordinary arms-length sale since the conservancy controls the use of the "sales proceeds" and, upon demand, is entitled to receive them. Because these are Habitat Conservation Fund moneys available to the Conservancy upon demand, we believe they are subject to the restrictions of the act.

4 We have not mischaracterized a debt, not yet payable, as state money. As stated in note 3 above, the Coastal Conservancy has complete control over these moneys. Further, these funds are payable to the Coastal Conservancy upon demand. Thus, although the nonprofit has possession of the money, the funds belong to the Coastal Conservancy. As such, we consider them to be state moneys that should be on deposit in the state treasury.

5 The Coastal Conservancy is incorrect. As stated in note 2, the purpose of this transaction was to shift $2 million from the more restrictive Habitat Conservation Fund to the Coastal Conservancy Fund. Therefore, the State realized no gain on the sale since it was simply a transfer from one state fund to another.

6 The Coastal Conservancy is incorrect. Although there may be no loss to the State, there is a loss to the Habitat Conservation Fund because $2 million earmarked for those purposes were transferred to the Coastal Conservancy Fund.

7 In our report, we cite the date on the loan agreement, March 1987.

8 In our report, we cite the date on the grant agreement, June 1996.

PETE WILSON
GOVERNOR

State and Consumer Services Agency

OFFICE OF THE SECRETARY
915 Capitol Mall, Suite 200
Sacramento, CA 95814

African American Museum
Building Standards Commission
Consumer Affairs
Fair Employment & Housing
Fair Employment & Housing Commission
Franchise Tax Board
General Services
Insurance Advisor
Museum of Science & Industry
Personnel Board
Public Employees' Retirement System
State Teachers' Retirement System

April 17, 1997

Kurt R. Sjoberg, State Auditor
Bureau of State Audits
660 J Street, Suite 300
Sacramento, California 95814

Dear Mr. Sjoberg:

RE: AUDIT REPORT NO. 95110
HABITAT CONSERVATION FUND: SOME STATE AGENCIES NEED TO DO MORE TO ENSURE THE FUND IS USED APPROPRIATELY

Attached is our response prepared by the Department of General Services to the Bureau of State Audits' Report No. 95110 entitled "Habitat Conservation Fund: Some State Agencies Need to do More to Ensure the Fund is Used Appropriately."

If you have any questions or need additional information, please contact me at 653-4090.

Sincerely,

George Valverde

GEORGE VALVERDE
Deputy Secretary

Attachment

State of California | State and Consumer Services Agency

Memorandum

Date: April 17, 1997 | File No.: 95110

To: Joanne C. Kozberg, Secretary
State and Consumer Services Agency
915 Capitol Mall, Room 200
Sacramento, CA 95814

From: **Department of General Services**
Executive Office

Subject: **RESPONSE TO BUREAU OF STATE AUDITS' REPORT NO. 95110 -- HABITAT CONSERVATION FUND: SOME STATE AGENCIES NEED TO DO MORE TO ENSURE THE FUND IS USED APPROPRIATELY.**

Thank you for the opportunity to respond to Bureau of State Audits' (BSA) Report No. 95110 which addresses recommendations to the Department of General Services' (DGS) Office of Real Estate and Design Services (OREDS). The following response addresses each of the recommendations.

OVERVIEW OF THE REPORT

The DGS has reviewed the findings and recommendations presented in Report No. 95110. As discussed in this response, the DGS will take appropriate actions to address the recommendations.

Overall, the DGS is pleased that the BSA's extensive and in-depth audit only disclosed concerns with one of the 13 land acquisitions included in the audit's scope. The 13 acquisitions totaled approximately $57 million of which the BSA expresses concern with an increment of $1.8 million paid for one acquisition, i.e., Point Lobos Ranch. OREDS' staff has reviewed the questioned acquisition and concluded that a properly calculated fair market value (FMV) was used in acquiring the property and that the transaction was conducted in compliance with state statutes. The State did not overpay $1.8 million to acquire the 1,312 acre Point Lobos Ranch property.

In prior correspondence with the BSA and extensive discussions with its staff, we expressed our disagreements with the BSA's conclusions related to the acquisition of the Point Lobos Ranch property. We continue to disagree with the BSA's conclusion that the OREDS did not protect the State's interest adequately when it acquired the property. The property was acquired after an extensive independent professional appraisal review determined the property's FMV. The professional appraisal review was performed by an OREDS' employee who had over 30 years of experience in the appraisal field. 1*

Our disagreements with the report's contents are numerous. However, it would serve no practical purpose to present each of them in this response. Instead, we will only comment on the key issue related to if the price paid for the Point Lobos Ranch property was based on a properly approved appraisal of the property's FMV.

The California State Auditor's comments on this response begin on page 89.

To comply with Government Code Section 7267.2, the State's offer to acquire the Point Lobos Ranch could not be for an amount less than the State's approved appraisal of the FMV of the property. To determine the Point Lobos Ranch's FMV, the OREDS used both an appraisal performed by the nonprofit entity referenced in the audit report and a critique of that appraisal prepared by an appraiser hired by the original owner. Further, the OREDS' appraisal reviewer contacted county planning staff to discuss the land use plan for the property and verified other relevant facts within the reports. The appraisal and critique were reviewed to ensure that they were conducted in conformance with accepted appraisal standards, principles and techniques. The critique was used to assist in the property's valuation under OREDS' policies that provide that, when a reviewer finds an appraisal unacceptable, he may opt to establish his own market value estimate using any available information. Based on his review of the nonprofit's appraisal, the owner's critique and his own research, the appraisal reviewer concluded that the property's FMV was $12.9 million which agreed with the amount presented in the critique prepared by the original property owner's appraiser. The concerns expressed in the report by the BSA result because this amount differed from the nonprofit appraiser's valuation of $9 million and the nonprofit's ultimately negotiated purchase price of $11.1 million.

As stated in the OREDS' appraisal reviewer report, the primary reason for the difference between the valuation of $9 million provided in the nonprofit's appraisal report and the valuation of $12.9 million provided in the critique performed for the owner was the level of density that might ultimately be approved for the property. The nonprofit's appraisal was based on a lower density of possible development. If the same density was agreed to by both parties, the difference between appraisals would have been only 5%. Since this is a relatively minor difference, the appraisal reviewer determined that another complete appraisal was unnecessary and that he could resolve the difference of opinion as to density and recommend a FMV for the property.

In brief, the primary reason that the nonprofit's appraiser recommended a lower density was due to possible environmental constraints that might ultimately reduce allowed development. After discussions with county planning staff, the OREDS' appraisal reviewer determined that a higher density development was allowed per the applicable land use plan and that it was pure speculation that environmental constraints would affect development. Therefore, he concluded that there were no specific conditions cited in either the appraisal report or the critique to justify basing the valuation at a lower density use and recommended the high density FMV of $12.9 million.

In summary, the OREDS continues to believe that an appropriate FMV was used to acquire the Point Lobos Ranch property. It has no reason to question the judgment of an appraisal reviewer who has over 30 years of experience in the appraisal field. The individual, who is now retired, is a well-known and respected appraisal professional who over his career reviewed and approved appraisals for billions of dollars worth of property acquisitions.

It should also be noted that, even though the nonprofit paid the original owner $1.8 million less than the State's valuation of FMV, the State is not relieved from paying FMV to acquire the property. The Point Lobos Ranch's FMV was properly calculated based on it's highest and best economic use. After determining FMV, as previously stated, the State was required by Government Code Section 7267.2 to offer an amount not less than FMV to acquire the property. It is not unusual for a nonprofit to acquire property at less than FMV prior to selling it to the State at FMV, just as it is not unusual for the opposite to occur, i.e., a nonprofit acquiring property at more than FMV prior to selling it to the State at FMV. In fact, on occasion, nonprofit organizations have received fully donated property that later was sold to the State at FMV.

The following response provides our comments on each recommendation addressed to OREDS in Chapter 3 of the report.

RECOMMENDATIONS

RECOMMENDATION #1: ***Do not execute purchase agreements with organizations or individuals that do not own the land being acquired and consider using letters of intent, similar to those used by federal government.***

DGS RESPONSE #1:

This recommendation resulted from one instance whereby a lease payment was paid prior to a lessor having title to a property. Specifically, in acquiring the Point Lobos Ranch property, the first lease payment of $1.5 million was made approximately one month prior to the nonprofit's closing of its purchase of the property. This transaction was part of the first and only ground lease with incremental transfer of fee title arrangement approved by the OREDS. As stated in previous correspondence with the BSA, it was not the State's intent to pay the nonprofit in advance of the closing of its purchase of the Point Lobos Ranch property. On April 21, 1993, in anticipation of the nonprofit having title on May 1, 1993, the OREDS authorized the issuance of a $1.5 million lease payment. At that time, the OREDS had in it's possession a fully signed lease dated April 14, 1993, that provided for the commencement of the lease on May 1, 1993. The first lease payment was scheduled to be paid by the State concurrently with the nonprofit's close of escrow on its purchase agreement with the original owner of the Point Lobos Ranch. This arrangement was entered into to allow the nonprofit to use the first lease payment as its down payment on the property.

The OREDS would not have authorized payment if it knew that the nonprofit's close of escrow on the purchase agreement for the Point Lobos Ranch was not going to occur on May 1, 1993. According to the nonprofit's General Counsel, escrow closing was delayed due to some unforeseen complexities in the description of the property that had to be clarified and some rights of access to be retained by the seller.

In retrospect, as we previously advised the BSA, the State should have required the first lease payment to be put into escrow until execution of the nonprofit's purchase agreement. However, in our opinion, the direct payment to the nonprofit was an extremely low risk transaction. The nonprofit had the same goals and objectives for the property as the State. If the nonprofit would not have ultimately purchased the property, we have no reason to believe that it would not have immediately returned the lease payment to the State.

As in the past, the current practice of the OREDS is to execute purchase agreements that contain contingencies that must be met by the parties to the agreement prior to it becoming legally binding and enforceable. The contingencies must be met prior to the close of escrow on the acquisition. The error in processing the Point Lobos Ranch transaction was not that the lease agreement did not have a proper contingency, i.e., the lease terms provided that the lease was contingent upon the lessor obtaining fee simple title to the property, it was that an escrow account was not used in finalizing the acquisition.

If future ground lease arrangements are used to acquire property, the OREDS will ensure that an escrow account is used for the transaction. Further, the OREDS will consider using letters

of intent rather that a formal purchase agreement in acquiring property.

RECOMMENDATION #2: ***Require individuals or organizations that facilitate land acquisitions to fully disclose the price and other terms and conditions of their land acquisitions before the Office of Real Estate agrees to a purchase price.***

DGS RESPONSE #2:

Although the OREDS will fully consider this recommendation, its preliminary conclusion is that there would be limited if any benefit to requiring individuals or organizations who facilitate land acquisitions to disclose price and other terms and conditions of their land acquisitions prior to the State agreeing to a property's purchase price. The OREDS' operating policy is to always offer FMV for property except when an informed property owner has formally listed the property at a price below FMV. This practice ensures the treatment of the citizens of the State of California in a fair manner by not "lowballing" unsophisticated sellers and prevents the incurrence of significant costs in repeatedly presenting and revising offers.

In the case of the Point Lobos Ranch acquisition which led to the BSA's recommendation, if the State had enforced this type of full disclosure requirement, the acquisition may not have occurred. It is our understanding that the nonprofit and the seller of the property had a confidentiality agreement to not disclose the terms of their agreement.

RECOMMENDATION #3: ***To ensure consistency in state land acquisitions, the Office of Real Estate should develop and distribute written policies and procedures for other state agencies that acquire real property. If the department does not pursue its role as a statewide policy setter, the Legislature should direct the Department of General Services to set these policies.***

DGS RESPONSE #3:

Over the last few years, the DGS has moved from a control philosophy to a customer service philosophy in its operations. As part of this process, state agencies have been empowered to take more responsibility for their own operations. This empowerment has reduced the need for detailed written policies and procedures. 2

Although we do not agree that the OREDS does not provide sufficient guidance for state property acquisitions, the OREDS will take action to develop and distribute guidelines to assist other state agencies that acquire real property. When the detailed policies and procedures were removed from the State Administrative Manual in June 1996, the OREDS planned to develop guidelines and have them available upon request. However, this activity has not been a priority due to the fact that no agency has made a request for the guidelines.

CONCLUSION

The DGS has a firm commitment to provide efficient and effective oversight of the State's land acquisition process. As part of its continuing efforts to improve policies over this process, the DGS will take appropriate actions to address the issues presented in the report.

If you need further information or assistance on this issue, please call me at 445-3441.

Steven A. Olsen for

PETER G. STAMISON, Director
Department of General Services

PGS:RG:ea:worddata:director:95110res

Comments

California State Auditor's Comments on the Response From the Department of General Services

To provide clarity and perspective, we are commenting on the Department of General Service's (department) response to our audit report. The following number corresponds to the number we have placed in the department's response.

1 In the ensuing paragraphs, the department describes its purchase of the Point Lobos Ranch from a nonprofit organization (nonprofit) as we describe it in our report. However, as we point out in the report, the department agreed to the purchase price of $12.9 million before the nonprofit acquired the ranch. The nonprofit subsequently acquired the ranch for $11.1 million. Since the nonprofit purchased the ranch in an arms-length transaction, we believe that $11.1 more accurately reflects the ranch's fair market value.

2 Although "empowerment" may reduce the level of detail needed in written policies and procedures, it does not eliminate the need for them or for centralized policysetting as the department's recent actions suggest. As we discuss on pages 30 through 32, because the number of agencies conducting their own property acquisitions is increasing, centralized policysetting and written guidance is essential to protect the State's interest, ensure consistency, and minimize cost.

cc: Members of the Legislature
Office of the Lieutenant Governor
Attorney General
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps